

# Financial Information



The ***Financial Information*** demonstrates our commitment to effective stewardship over the funds DHS receives to carry out the mission of the Department, including compliance with relevant financial management legislation. It includes the ***Independent Auditor's Report***, an independent opinion on the Balance Sheet and Statement of Custodial Activities provided by the Department's Office of Inspector General (OIG), and provides the Department's ***Annual Financial Statements*** and accompanying ***Notes to the Financial Statements***.

## Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the *Chief Financial Officers Act of 1990 (P.L. 101-576)*, as amended by the *Government Management Reform Act of 1994 (P.L. 103-356)*. Other requirements include the Office of Management and Budget (OMB) Circular Number A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. An independent certified public accounting firm, selected by the Department's Inspector General, was engaged to audit the Balance Sheet and the Statement of Custodial Activity. The independent auditors' report accompanies the principal financial statements. These financial statements include the following:

- The **Balance Sheets** present as of September 30, 2007 and 2006, those resources owned or managed by DHS which represent future economic benefits (assets); amounts owed by DHS that will require payments from those resources or future resources (liabilities); and residual amounts retained by DHS comprising the difference (net position).
- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2007 and 2006. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.
- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2007 and 2006.
- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2007 and FY 2006, the status of these resources at September 30, 2007 and 2006, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2007 and 2006.
- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2007 and 2006.
- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the Financial Statements for the fiscal years ended September 30, 2007 and 2006.

### Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of Title 31, United States Code, Section 3515 (b) relating to financial statements of Federal agencies. While the statements have been prepared from the books and records of the agency in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for Federal agencies and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

## Independent Auditors' Report

### DEPARTMENT OF HOMELAND SECURITY Office of Inspector General

### Independent Auditors' Report on DHS' FY 2007 Financial Statements



OIG-08-12

November 2007

Office of Inspector General

U.S. Department of Homeland Security  
Washington, DC 20528



**Homeland  
Security**

### Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the Homeland Security Act of 2002 (*Public Law 107-296*) by amendment to the *Inspector General Act of 1978*. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

The attached report presents financial information excerpted from DHS' *Annual Financial Report* (AFR) and the results of the DHS financial statement audits for fiscal year (FY) 2007 and FY 2006. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheet as of September 30, 2007 and 2006. The FY 2007 auditor's report discusses eight significant deficiencies, seven of which are considered material weaknesses in internal control, and eight instances of noncompliance with laws and regulations. KPMG is responsible for the attached auditor's report dated November 15, 2007, and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or internal control or conclusions on compliance with laws and regulations.

The recommendations herein have been discussed in draft with those responsible for implementation. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in black ink, reading "Richard L. Skinner".

Richard L. Skinner  
Inspector General



**Independent Auditor's Report on  
DHS' FY 2007 Financial Statements**

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Office of Inspector General

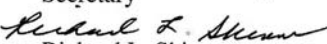
U.S. Department of Homeland Security  
Washington, DC 20528



**Homeland  
Security**

NOV 15 2007

MEMORANDUM FOR: The Honorable Michael Chertoff  
Secretary

FROM:   
Richard L. Skinner  
Inspector General

SUBJECT: *Independent Auditors' Report on DHS' FY 2007 Balance Sheet and  
Statement of Custodial Activity*

The attached report presents the results of the Department of Homeland Security's (DHS or Department) financial statement audits for fiscal year (FY) 2007 and FY 2006. These audits were required by the *Chief Financial Officers Act of 1990*. This report is incorporated into the *Department's FY 2007 Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits.

Generally the corrective action plans for DHS's non-military components, except for FEMA, have started to show results of improving financial reporting during FY 2007, although overall the department still has much work remaining. For the fourth year, KPMG was unable to provide an opinion on the department's balance sheet; although elements and conditions of prior year weaknesses have been corrected, material weaknesses exist in the same processes as in prior years.

#### **Summary**

KPMG was unable to express an opinion on the Department's balance sheets as of September 30, 2007 and 2006 and on the related statements of custodial activity for the years then ended, because DHS was unable to represent that certain financial statement balances were correct, and unable to provide sufficient evidence to support its financial statements. In connection with the audits, DHS' internal controls over financial reporting and compliance with certain provisions of laws and regulations were considered. As a result, the FY 2007 Independent Auditors' Report discusses seven material weaknesses, one other significant deficiency in internal control, and eight instances of non-compliance with laws and regulations, as follows:

#### **Significant Deficiencies That Are Considered To Be Material Weaknesses**

- A. Financial Management and Entity-level Controls
- B. Financial Reporting
- C. Financial Systems Security
- D. Fund Balance with Treasury

- E. Capital Assets and Supplies
- F. Actuarial and Other Liabilities
- G. Budgetary Accounting

**Other Significant Deficiency**

- H. Custodial Revenue and Drawback

**Non-compliance with Laws and Regulations**

- I. Federal Managers' Financial Integrity Act of 1982 (FMFIA)
- J. Federal Financial Management Improvement Act of 1996 (FFMIA)
- K. Single Audit Act Amendments of 1996, and laws and regulations supporting OMB Circular No. A-50, Audit Follow-up, as revised
- L. Improper Payments Information Act of 2002 (IPIA)
- M. Chief Financial Officers Act of 1990
- N. Government Performance and Results Act of 1993 (GPRA)
- O. Debt Collection Improvement Act of 1996 (DCIA)
- P. Anti-deficiency Act

**Moving DHS' Financial Management Forward**

While the auditors' noted improvement toward correction of internal control weaknesses, the Department was unable to represent that its financial statements as of, and for the year ended, September 30, 2007, were presented in conformity with U.S. generally accepted accounting principles. The U.S. Coast Guard, (USCG), DHS-HQ / Office of Financial Management (OFM), and Federal Emergency Management Agency (FEMA), were unable to provide sufficient evidence to support account balances presented in the financial statements and collectively contributed to the auditors' inability to render an opinion.

However, OFM has fully corrected its material weakness in *Financial Management and Entity Level Controls* reported in FY 2006. Additionally, in FY 2007 OFM, Immigration and Customs Enforcement (ICE), Customs and Border Protection (CBP), US-Visit and the Federal Law Enforcement Training Center (FLETC) mitigated the severity of their financial systems security material weaknesses through corrective actions implemented during 2006 and 2007, but have not completely resolved their financial systems security control weaknesses as of September 30, 2007.

The Coast Guard began FY 2007 with a focus on financial management oversight, financial reporting, and fund balance with Treasury. However, the Coast Guard was not able to fully remediate prior year control weaknesses, and the auditors again reported that the Coast Guard contributed to all seven material weaknesses, and did not have an organizational structure that fully supported the development and implementation of effective policies, procedures, and internal controls. Management officials within the Coast Guard acknowledged to the auditors that

longstanding procedural, control, personnel, and cultural issues existed and had impeded their progress in installing an effective financial management structure. The auditors' reported that the Coast Guard's personnel rotation policy, among other issues, made it difficult for the Coast Guard's Chief Financial Officer to institutionalize internal controls related to financial management and reporting.

Conditions at FEMA deteriorated in FY 2007 with FEMA now contributing to six material weaknesses instead of two material weaknesses in FY 2006. The auditors identified that FEMA has not established a financial management organizational structure, with clear oversight and supervisory review functions that support the development and implementation of effective policies, procedures, and internal controls over financial reporting, to ensure that accounting principles are correctly applied, and accurate financial data is submitted to OFM for consolidation in a timely manner. The auditors also noted that the FEMA Chief Financial Officer does not have clearly defined and complete authority and responsibility for all financial accounting policy, processes and control functions throughout the agency.

Many of the DHS' difficulties in financial management and reporting can be attributed to the original stand-up of a large, new, and complex executive branch agency without adequate organizational expertise in financial management and accounting. Although the Department made strides in remediating weaknesses during FY 2007, it has committed to focusing on remediation efforts at USCG and FEMA, while sustaining progress made throughout FY 2007. Additionally, the department remains committed to obtaining additional human resources and other critical infrastructure necessary to develop reliable financial processes, policies, procedures, and internal controls that will enable management to represent that financial statements are complete and accurate. These resources and infrastructure are critical to the implementation of effective corrective actions and to establishing an effective financial management oversight function. During the past year, the Department and its components continued the extensive effort to develop meaningful corrective action plans to address specific material internal control weaknesses. We are evaluating the effectiveness of those corrective action plans in a separate series of audits.

\*\*\*\*\*

KPMG is responsible for the attached independent auditor's report dated November 15, 2007, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the Inspector General Act, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the Department. In addition, we will post a copy of the report on our public website.

We request that each of the Department's chief financial officers provide us with a corrective action plan that demonstrates their progress in addressing the report's recommendations.



We appreciate the cooperation extended to the auditors by the department's financial offices. Should you have any questions, please call me, or your staff may contact Anne Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment



KPMG LLP  
2001 M Street, NW  
Washington, DC 20036

## INDEPENDENT AUDITORS' REPORT

Secretary and Inspector General  
U.S. Department of Homeland Security:

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). In connection with our fiscal year 2007 audit, we also considered DHS' internal controls over financial reporting, and DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2007 and 2006 (referred to herein as "other fiscal year 2007 and 2006 financial statements").

### Summary

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2007 and 2006, or the related statements of custodial activity for the years then ended.

In fiscal year 2007, DHS changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations, and changed its method of reporting certain mixed funding budgetary authority.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as significant deficiencies:

- A. Financial Management and Entity Level Controls
- B. Financial Reporting
- C. Financial Systems Security
- D. Fund Balance with Treasury
- E. Capital Assets and Supplies
- F. Actuarial and Other Liabilities
- G. Budgetary Accounting
- H. Custodial Revenue and Drawback

We consider significant deficiencies A through G, above, to be material weaknesses.

We noted that DHS did not present five years of Required Supplemental Stewardship Information (RSSI) information, as required by U.S. generally accepted accounting principles.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*:

- I. *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*
- J. *Federal Financial Management Improvement Act of 1996 (FFMIA)*



- K. *Single Audit Act Amendments of 1996*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- L. *Improper Payments Information Act of 2002*
- M. *Chief Financial Officers Act of 1990*
- N. *Government Performance and Results Act of 1993*
- O. *Debt Collection Improvement Act of 1996*
- P. *Anti-deficiency Act*

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD) and at the Federal Law Enforcement Training Center (FLETC).

Other internal control matters and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheets as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended, and had we been engaged to audit the other fiscal year 2007 and 2006 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS balance sheets as of September 30, 2007 and 2006, and on the statements of custodial activity for the years then ended; our consideration of DHS' internal control over financial reporting; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

#### **Report on the Financial Statements**

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2007 and 2006.

The United States Coast Guard (Coast Guard) was unable to provide sufficient evidential matter or make knowledgeable representations of facts and circumstances, that support transactions and account balances of the Coast Guard, as presented in the DHS balance sheets at September 30, 2007 and 2006; particularly with respect to fund balance with Treasury, accounts receivable, inventory and related property, certain categories of property, plant and equipment, actuarially-derived liabilities, environmental and other liabilities, undelivered orders and changes in net position, and adjustments, both manual and automated, made as part of Coast Guard's financial reporting process. The Coast Guard was unable to complete corrective actions, and make adjustments, as necessary, to these and other balance sheet amounts, prior to the completion of the DHS 2007 *Annual Financial Report* (AFR). Because of the significance of these account balances and/or transactions and conditions noted above, Coast Guard management was unable to represent that the Coast Guard's balance sheets as of September 30, 2007 and 2006, were fairly stated in conformity with U.S. generally accepted accounting principles. The total assets of Coast Guard, as reported in the accompanying DHS balance sheet, were \$15.9 billion and \$12.5 billion, or 20 percent and 16 percent of total DHS consolidated assets as of September 30, 2007 and 2006, respectively.

DHS Office of Financial Management (OFM) and certain DHS components were unable to reconcile intragovernmental transactions and balances with other Federal trading partners totaling approximately \$1.5 billion as of September 30, 2007, prior to the completion of the DHS 2007 AFR. In addition, DHS was unable to provide sufficient evidential matter to support its recording of \$1.5 billion in both fund balance with Treasury and undelivered orders at September 30, 2007, resulting from a budgetary allocation transfer made by the Office of Health Affairs (OHA), a DHS component, to another Federal agency, in fiscal year 2007. Because of the significance of this allocation transfer, DHS management was unable to represent that the balance sheet of OHA is fairly stated in conformity with U.S. generally





- K. *Single Audit Act Amendments of 1996*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- L. *Improper Payments Information Act of 2002*
- M. *Chief Financial Officers Act of 1990*
- N. *Government Performance and Results Act of 1993*
- O. *Debt Collection Improvement Act of 1996*
- P. *Anti-deficiency Act*

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD) and at the Federal Law Enforcement Training Center (FLETC).

Other internal control matters and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheets as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended, and had we been engaged to audit the other fiscal year 2007 and 2006 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS balance sheets as of September 30, 2007 and 2006, and on the statements of custodial activity for the years then ended; our consideration of DHS' internal control over financial reporting; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

#### **Report on the Financial Statements**

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2007 and 2006.

The United States Coast Guard (Coast Guard) was unable to provide sufficient evidential matter or make knowledgeable representations of facts and circumstances, that support transactions and account balances of the Coast Guard, as presented in the DHS balance sheets at September 30, 2007 and 2006; particularly with respect to fund balance with Treasury, accounts receivable, inventory and related property, certain categories of property, plant and equipment, actuarially-derived liabilities, environmental and other liabilities, undelivered orders and changes in net position, and adjustments, both manual and automated, made as part of Coast Guard's financial reporting process. The Coast Guard was unable to complete corrective actions, and make adjustments, as necessary, to these and other balance sheet amounts, prior to the completion of the DHS 2007 *Annual Financial Report* (AFR). Because of the significance of these account balances and/or transactions and conditions noted above, Coast Guard management was unable to represent that the Coast Guard's balance sheets as of September 30, 2007 and 2006, were fairly stated in conformity with U.S. generally accepted accounting principles. The total assets of Coast Guard, as reported in the accompanying DHS balance sheet, were \$15.9 billion and \$12.5 billion, or 20 percent and 16 percent of total DHS consolidated assets as of September 30, 2007 and 2006, respectively.

DHS Office of Financial Management (OFM) and certain DHS components were unable to reconcile intragovernmental transactions and balances with other Federal trading partners totaling approximately \$1.5 billion as of September 30, 2007, prior to the completion of the DHS 2007 AFR. In addition, DHS was unable to provide sufficient evidential matter to support its recording of \$1.5 billion in both fund balance with Treasury and undelivered orders at September 30, 2007, resulting from a budgetary allocation transfer made by the Office of Health Affairs (OHA), a DHS component, to another Federal agency, in fiscal year 2007. Because of the significance of this allocation transfer, DHS management was unable to represent that the balance sheet of OHA is fairly stated in conformity with U.S. generally





accepted accounting principles at September 30, 2007. The total assets of OHA, as reported in the accompanying DHS balance sheet as of September 30, 2007, were \$3.3 billion or 4 percent of total DHS consolidated assets. In fiscal year 2006, OFM and certain DHS components were unable to provide sufficient evidential matter supporting the completeness and accuracy of the Department's accrued legal liability totaling \$71 million as of September 30, 2006, and related contingent legal liabilities as disclosed in Note 21 to the financial statements; reconcile intragovernmental transactions and balances with other Federal trading partners totaling \$3.5 billion, as of September 30, 2006; or provide sufficient evidential matter or make knowledgeable representations of the facts and circumstances that support its implementation of Statement of Federal Financial Accounting Standard (SFFAS) No. 27, *Identifying and Reporting Earmarked Funds*, prior to the completion of DHS' 2006 *Performance and Accountability Report* (PAR).

Federal Emergency Management Agency (FEMA) was unable to fully support the accuracy and completeness of certain stockpiled supplies, unpaid obligations related to mission assignments, and certain grants payable/advances, and the related effects on net position, if any, prior to the completion of the DHS 2007 AFR. The stockpiled supplies, as reported in the accompanying DHS balance sheet as of September 30, 2007 were \$243 million or 38 percent of DHS' consolidated inventory and related property. FEMA's unpaid obligations related to mission assignments, as reported in the accompanying DHS balance sheet as of September 30, 2007, were \$2.6 billion or 5 percent of DHS' consolidated unexpended appropriations. FEMA's net grants payable/advances, as reported in the DHS balance sheet as of September 30, 2007, were \$149 million or 3 percent of DHS' consolidated accounts payable. The total net position of FEMA as reported in the accompanying DHS balance sheet as of September 30, 2007, was \$10.1 billion or 12.8 percent of DHS' consolidated liabilities and net position. In fiscal year 2006, FEMA was unable to fully support the accuracy and completeness of certain unpaid obligations and accounts payable, and the related effect on net position, if any, prior to the completion of DHS' 2006 PAR. FEMA's unpaid obligations, as reported in the accompanying DHS balance sheet as of September 30, 2006, were \$22.3 billion or 46 percent of DHS' consolidated unexpended appropriations. FEMA's accounts payable, as reported in the DHS balance sheet as of September 30, 2006, were \$1.5 billion or 33 percent of DHS' consolidated accounts payable. The total net position of FEMA as reported in the accompanying DHS balance sheet as of September 30, 2006, was \$11.2 billion or 14 percent of DHS' consolidated liabilities and net position.

In fiscal year 2006, Transportation Security Administration (TSA) was unable to provide sufficient evidential matter or make knowledgeable representations of facts and circumstances that support certain transactions and account balances of TSA, as presented in the DHS balance sheet at September 30, 2006, particularly with respect to property and equipment, accounts payable, accrued unfunded employee leave, and the components of net position. Because of the significance of these account balances and/or transactions and conditions noted above, TSA management was unable to represent that TSA's balance sheet as of September 30, 2006, was fairly stated in conformity with U.S. generally accepted accounting principles. The total assets of TSA as reported in the accompanying DHS balance sheet as of September 30, 2006, were \$4.1 billion or 5 percent of DHS consolidated assets.

In fiscal year 2006, Immigration and Customs Enforcement (ICE), was unable to fully support the accuracy and completeness of certain accounts payable and undelivered orders, and the related effect on net position, if any, prior to the completion of the DHS 2006 PAR. ICE's accounts payable and undelivered orders, as reported in the accompanying DHS balance sheet as of September 30, 2006, were \$319 million or 7 percent of DHS' consolidated total accounts payable, and \$1.2 billion or 2.5 percent of DHS' consolidated unexpended appropriations, respectively.

In fiscal year 2006, the Management Directorate was unable to fully support the accuracy and completeness of certain accounts payable and undelivered orders, and the related effect on net position, if any, prior to the completion of the DHS 2006 PAR. The Management Directorate's accounts payable and undelivered orders, as reported in the accompanying DHS balance sheet as of September 30, 2006,



were \$60 million or 1.3 percent of consolidated total accounts payable, and \$527 million or 1.1 percent of DHS consolidated unexpended appropriations, respectively.

In addition, we were unable to obtain appropriate representations from DHS management, regarding the matters described above, including certain representations as to compliance with U.S. generally accepted accounting principles, with respect to the accompanying DHS balance sheets and related statements of custodial activity as of and for the years ended September 30, 2007 and 2006, and were unable to determine the effect of the lack of such representations on the 2007 and 2006 DHS' financial statements.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the seven preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2007 and 2006, and accordingly, we do not express an opinion on these financial statements.

As discussed in Note 34, DHS restated its fiscal year 2006 financial statements to correct multiple errors identified by TSA, ICE, NPPD, United States Citizenship and Immigration Services, Science and Technology Directorate, FLETC, and Management Directorate that required adjustment of balances previously reported in DHS' fiscal year 2006 financial statements. Because of the matters discussed above regarding our fiscal year 2006 audit, and the control deficiencies described in our report on internal control over financial reporting, we were unable to audit the restatements discussed in Note 34, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2006.

As discussed in Notes 35 and 36 to the financial statements, in fiscal year 2007, DHS changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations and changed its method of reporting certain mixed funding budgetary authority.

The information in the Management's Discussion and Analysis (MD&A), RSSI, and Required Supplementary Information (RSI) sections of the DHS AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular A-136. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards, because of the limitations on the scope of our audit described in the previous paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on fiscal year 2007 and 2006 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI and, accordingly, we express no opinion on it. However, in fiscal year 2007, we noted that DHS did not present five years of RSSI information that U.S. generally accepted accounting principles has determined is necessary to supplement, although not required to be part of, the financial statements.

The information in pages 12 through 23, Section II – Performance Achievements and Key Performance Measures, Section IV – Other Accompanying Information, and Section V – Appendices, of DHS' 2007 AFR are presented for purposes of additional analysis, and are not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

#### **Internal Control over Financial Reporting**

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.





A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects DHS' ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of DHS' financial statements that is more than inconsequential will not be prevented or detected by DHS' internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by DHS' internal control.

Significant deficiencies in internal control over financial reporting and its operation are described in Exhibits I, II, and III. Deficiencies that are considered to be material weaknesses at the Coast Guard, when aggregated at the consolidated level, are presented in Exhibit I. Deficiencies that are considered to be material weaknesses at DHS-Headquarters (HQ), OFM, and all other DHS components, when aggregated at the consolidated level, are presented in Exhibit II. Exhibit III presents other significant deficiencies that are not considered to be material weaknesses. As discussed in the Report on the Financial Statements section, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended, and accordingly, other internal control matters may have been identified and reported had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other fiscal year 2007 and 2006 financial statements. A summary of the status of fiscal year 2006 reportable conditions is included as Exhibit V.

We also noted certain additional matters involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

#### **Compliance and Other Matters**

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the FFMIA, disclosed eight instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit IV.

The results of our tests of compliance exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA, disclosed instances described in Exhibits I, II and III where DHS' financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2007 and 2006, and the related statements of custodial activity for the years then ended, and accordingly, other instances of non-compliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other fiscal year 2007 and 2006 financial statements.

**Other Matters.** NPPD management has initiated a review of the classification and use of certain funds that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriation law in fiscal year 2007 or in previous years. In addition, FLETC management has initiated a review of the classification of certain liabilities, recorded in their accounting records that may identify a violation of



the *Anti-deficiency Act*, or other violations of appropriation law that may have occurred during fiscal year 2007 or during previous years.

#### **Management's Response to Internal Control and Compliance Findings**

DHS management has indicated, in a separate letter immediately following this report, that it concurs with the findings presented in Exhibits I, II, III, and IV of our report. We did not audit DHS's response and, accordingly, we express no opinion on it.

#### **Responsibilities**

**Management's Responsibilities.** The United States Code, Title 31, Sections 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, DHS prepares and submits financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the MD&A (including the performance measures), RSI, and RSSI;
- Establishing and maintaining effective internal control; and
- Complying with laws, regulations, contracts, and grant agreements applicable to DHS, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

**Auditors' Responsibilities.** As discussed in the report on the financial statements section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the DHS balance sheets as of September 30, 2007 and 2006, or on the related statements of custodial activity for the years then ended; and we were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2007 and 2006.

In connection with our fiscal year 2007 engagement, we considered DHS' internal control over financial reporting by obtaining an understanding of DHS' internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our procedures. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the FFMIA. The objective of our engagement was not to provide an opinion on the effectiveness of DHS' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DHS' internal control over financial reporting. Further, other matters involving internal control over financial reporting may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2007, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other fiscal year 2007 financial statements.

In connection with our fiscal year 2007 engagement, we performed tests of DHS' compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the balance sheet amounts as of September 30, 2007, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the DHS. However, providing an opinion on compliance with laws,





regulations, contracts, and grant agreements was not an objective of our engagement and, accordingly, we do not express such an opinion. In addition, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2007, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other fiscal year 2007 financial statements.

Under OMB Bulletin No. 07-04 and FFMIA, we are required to report whether DHS' financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. However, as discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the balance sheet as of September 30, 2007, and the related statement of custodial activity for the year then ended, and accordingly, other instances of non-compliance may have been identified and reported, had we been able to perform all procedures necessary to express an opinion on the those financial statements, and had we been engaged to audit the other fiscal year 2007 financial statements.

**Restricted Use**

This report is intended solely for the information and use of DHS management, DHS Office of Inspector General, OMB, U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

November 15, 2007

**Independent Auditors' Report****Introduction to Exhibits on Internal Control and Compliance and Other Matters**

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. The internal control weaknesses, and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the Department of Homeland Security (DHS or Department) balance sheet and related statement of custodial activity as of and for the year ended September 30, 2007. We were not engaged to audit the Department's fiscal year 2007 statements of net cost, changes in net position, and budgetary resources (referred to as other fiscal year 2007 financial statements). Our findings and the status of prior year findings are presented in five exhibits:

- Exhibit I** Significant deficiencies in internal control identified at the Coast Guard. All of the significant deficiencies reported in Exhibit I are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit II, are considered material weaknesses at the DHS consolidated financial statement level.
- Exhibit II** Significant deficiencies in internal control identified at other DHS components and the Office of the Chief Financial Officer (collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit I, are considered material weaknesses at the DHS consolidated financial statement level.
- Exhibit III** A significant deficiency that is not considered a material weakness at the DHS consolidated financial statement level.
- Exhibit IV** Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.
- Exhibit V** The status of our findings reported in fiscal year 2006.

As stated in our Independent Auditors' Report, our consideration of internal control over financial reporting would not necessarily disclose all matters that might be significant deficiencies or instances of noncompliance. We were not engaged to audit the other 2007 financial statements. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, other internal control matters and instances of noncompliance may have been identified and reported had we been engaged to audit all of the FY 2007 financial statements, and had we been able to perform all procedures necessary to express an opinion on those financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how all component conditions, considered in aggregate, may affect the DHS balance sheet as of September 30, 2007 or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the material weaknesses identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2005 and FY 2006 report, and include updates for new findings resulting from our 2007 audit procedures. To provide trend information for the DHS Civilian Components, Exhibit II contains a Trend Table next to the heading of each finding, except Exhibit II-C, *Financial Systems Security*. The Trend Table depicts the level and current status of findings, by component, that have contributed to that finding from 2005 through

**Independent Auditors' Report****Introduction to Exhibits on Internal Control and Compliance and Other Matters**

2007. Significant deficiencies and material weaknesses, by component, included in the Exhibit II trend tables, are presented below.

The table below presents a summary of our internal control findings, by component, for fiscal year 2007. We have reported seven material weaknesses at the Department level in 2007, which is reduced from ten reported in 2006. While the DHS Civilian Components have made substantial progress in correcting control deficiencies, as shown in the Trend Tables in Exhibit II, the reduction in material weaknesses at the Department level in 2007 is due to a consolidation of findings into fewer, but broader categories for reporting purposes.

| SUMMARIZED DHS FY 2007 INTERNAL CONTROL FINDINGS |                                 |             |             |     |      |     |            |     |       |
|--|---------------------------------|-------------|-------------|-----|------|-----|------------|-----|-------|
|  |                                 | Coast Guard | DHS HQ      | CBP | FEMA | ICE | US - Visit | TSA | FLETC |
| Material Weaknesses                              |                                 | Exhibit I   | Exhibit II  |     |      |     |            |     |       |
| A  | Financial Management & ELC      | MW          |             |     | MW   |     |            |     |       |
| B  | Financial Reporting             | MW          | MW          |     | MW   |     |            | SD  |       |
| C  | Financial Systems Security      | MW          | SD          | SD  | MW   | SD  |            | MW  | SD    |
| D  | Fund Balance With Treasury      | MW          |             |     |      |     |            |     |       |
| E  | Capital Assets and Supplies     | MW          |             |     | MW   |     | SD         | SD  |       |
| F  | Actuarial and Other Liabilities | MW          |             |     | MW   |     |            | SD  |       |
| G  | Budgetary Accounting            | MW          |             |     | MW   |     |            | MW  |       |
| Significant Deficiencies                         |                                 |             | Exhibit III |     |      |     |            |     |       |
| H  | Custodial Revenue and Drawback  |             | SD          |     |      |     |            |     |       |

**SD** Significant Deficiency (SD's in Exhibit II contribute to Department level material weakness )

**MW** Material Weakness (individually, or when combined with other findings, result in Department level material weakness)

All components of DHS, as defined in Note 1A – *Reporting Entity*, to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2007 and the related statement of custodial activity for the year then ended. Accordingly, our audit considered significant account balances and transactions of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above, did not individually, or when combined with other component findings, contribute to a reportable control deficiency at the DHS consolidated financial statement level.

**Independent Auditors' Report**  
**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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**I-A Financial Management and Entity-Level Controls**

*Background:* In FY 2006, we reported that significant weaknesses in financial management oversight hindered the United States Coast Guard's (Coast Guard) ability to prepare accurate, complete, and timely financial information. Those conditions have not been corrected and continue to affect Coast Guard's financial management and reporting processes. During FY 2007, the Coast Guard developed a Corrective Action Plan (CAP) called the *Financial Strategy for Transformation and Audit Remediation* (FSTAR) to address the conditions described below, and throughout this Exhibit. However, significant steps to correct the conditions that cause the material weaknesses in internal control are not planned until after 2007.

*Conditions:* Many of the conditions described below are indicators of a weak control environment or entity-level controls. The control environment begins at the top with the Commandant, and permeates the organization with a mindset of quality, care, and commitment of resources to reasonably ensure the integrity of the Coast Guards' financial processes, controls, and information technology (IT) systems. We noted the following conditions related to the control environment which existed in prior years, and have been updated for this report.

The Coast Guard has not fully implemented a financial management organizational structure where:

- U.S. generally accepted accounting principles (GAAP) are applied and financial statement balances are appropriately supported, resulting in the Coast Guard not being able to assert to the completeness, existence (validity), accuracy, valuation, or presentation of their financial data.
- Appropriate and clear internal reporting relationships have been established resulting in effective financial guidance and oversight over internal and external distribution of financial information, particularly related to the *Federal Managers' Financial Integrity Act of 1982* (FMFIA).
- Clear and complete authority and responsibility for all financial accounting policy, processes, and control functions vests with the Coast Guard Chief Financial Officer (CFO).
- Financial management oversight functions, complete with an organizational chart, job descriptions, roles and responsibilities, and skill sets required, are defined.
- The financial management infrastructure is appropriately staffed with experienced financial managers and staff, to expeditiously identify and address control weaknesses, and develop and implement effective policies, procedures, and internal controls to ensure that data supporting financial statement assertions are complete and accurate.
- The objectives of sound fiscal management, as defined by various government sources, described in the criteria section below, are embraced by all officers and personnel of the Coast Guard.

*Cause/Effect:* The Coast Guard's management has acknowledged that longstanding procedural, control, personnel, and cultural issues have impeded progress toward installing an effective financial management structure. In addition, the Coast Guard's CFO must coordinate with heads of various divisions who have a role in the accounting and financial reporting processes, but who otherwise have limited exposure to financial statement audits. Further, these division heads change regularly as part of the Coast Guard military assignment and rotation policies, making it

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**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

difficult for the CFO to institutionalize internal controls related to financial management and reporting that are outside the CFO's direct organization. The conditions described above continue to prevent the Coast Guard and DHS from timely preparation of accurate financial information and reports and have also contributed to the conditions reported in Exhibit I-B, *Financial Reporting*, as well as other material weaknesses described in this Exhibit.

*Criteria:* OMB Circular No. A-123, Revised, *Management's Responsibility for Internal Control*, defines internal controls as the organization, policies, and procedures used by agencies to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported, and used for decision making.

FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government (Standards)*. The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* identify the control environment, as one of the five key elements of control, which emphasizes the importance of control conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, and segregation of duties, policies, procedures, and monitoring.

OMB Circular No. A-50, *Audit Follow-up*, as revised, states that corrective action taken by management on audit findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

*Recommendations:* We recommend that the Coast Guard:

1. Initialize the CAP/FSTAR process with an assessment of the control environment (entity-level controls), develop effective corrective actions, and implement improved financial processes and systems;
2. Delegate responsibility for sound fiscal management centrally with the CFO who has full authority to implement change as needed, including new policies, procedures, controls and IT systems requirements, to have the ability, and appropriate resources for Coast Guard financial management and reporting functions;
3. Engage an expert from outside the organization to evaluate the existing financial management organizational and internal control structure. The organizational specialist should conduct an assessment of the financial management organizational structure to consider the conditions cited above. In addition, the organizational specialist should consider other conditions identified in Exhibit I-B, *Financial Reporting*, below, such as the number and type of personnel and resources needed, along with the requisite skills and abilities necessary, to provide effective guidance and oversight to program offices that are significant to financial management and reporting, and make recommendations to senior management for appropriate changes; and

**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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4. Ensure that its CAP/FSTAR actions as designed and performed are:
  - a) Effective in addressing all of the material weakness described in this Exhibit; and
  - b) Coordinated and prioritized with the input from Department's CFO to address matters that are preventing the Department from preparing reliable financial statements and executing its fiscal management responsibilities.

**I-B Financial Reporting**

*Background:* In FY 2006, we reported that the Coast Guard had numerous internal control weaknesses that led to a material weakness in financial reporting. While the Coast Guard developed FSTAR to address the control weaknesses, they were not able to make substantial progress in execution of their corrective actions, and, consequently, many of the conditions reported in prior years are repeated below.

*Conditions:* The Coast Guard:

- Has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers are significantly noncompliant with the requirements of the *Federal Financial Management Improvement Act* (FFMIA). Specifically:
  - The general ledgers are not compliant with the United States Standard General Ledger (USSGL) at the transaction level, include noncompliant chart of account definitions, invalid accounts, improper posting logic codes and inconsistent crosswalks to the Coast Guard *Treasury Information Executive Repository* (TIER) database. The general ledgers also have static balances related to a legacy general ledger conversion and unsubstantiated automated changes to CAS financial data through the use of hundreds of scripts, implemented without effective controls to correct system problems;
  - The Coast Guard's TIER submissions to the Department's Office of Financial Management (OFM) are from a database that does not have detail at the transactional level, and is not reconciled or supported by the transaction level detail in the Coast Guard's three general ledgers; and
  - The financial reporting process is overly complex and labor intensive, and requires a significant number of "on-top" adjustments (adjustments made outside the core accounting system for presentation of financial information given to the Department for consolidation). These topside adjustments are not supported at the transaction level and are not recorded to the respective general ledgers at a detailed transactional level. Thus, period-end and opening balances are only supported by the Coast Guard TIER database, and the three general ledgers do not support the financial statements.
- Has significant deficiencies in its policies, procedures, and controls surrounding its financial reporting process. For example, the Coast Guard does not have
  - Effective procedures to support beginning balance, year-end close out and the cumulative results of operation analysis;
  - A process to record all financial transactions, in detail at the transactional level, to the general ledger systems;

**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

- Effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, and identified potential errors in its financial data;
- Effective procedures and internal controls over the process of preparing and reviewing adjustments to account balances, and financial statement disclosures, and uses high-level analytical comparisons to identify adjusting entries;
- Effective procedures to assess potential financial system problems, such as potential posting logic errors and automated changes to financial data through scripts (system modifications);
- Fully effective and accurate reporting tools for financial data analysis (Facts & Figures Quick Report Tool);
- An effective process to record, review, and monitor accounts receivable activity;
- Effective policies, procedures, and internal controls to compile, support, review, and report financial statement disclosures submitted for incorporation in the DHS financial statements, to include the effective completion the GAO Disclosure Checklist and valid support for the preparation of statement of net cost disclosure; and
- A validated, comprehensive process, to include effective internal controls, to fully track and reconcile intragovernmental transactions with its Federal trading partners, especially those outside DHS, and to determine that Coast Guard intragovernmental balances, as reported in the DHS financial statements, are complete, accurate, appropriately valued, belong to Coast Guard, and presented properly in the financial statements.

*Cause/Effect:* Many of the issues mentioned above stem from the conditions described in Exhibit I-A *Financial Management and Entity-Level Controls*. At the Coast Guard, the accuracy of financial information is highly dependent on the knowledge and experience of a limited number of key financial personnel rather than on clearly documented procedural manuals and process-flow documentation. In addition, the Coast Guard has serious general ledger structural and IT system functionality deficiencies that make the financial reporting process more complex and difficult. Consequently, the Coast Guard can not be reasonably certain that its financial statements are complete or accurate at any time. In its annual Assurance Statement provided to the DHS Secretary in September 2007, the Coast Guard was unable to provide reasonable assurance that internal controls over financial reporting are operating effectively, and was unable to represent to us that any significant balance sheet line items are fairly stated at September 30, 2007.

*Criteria:* FFMIA Section 803(a) requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal system requirements, and (3) the USSGL at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the GAO *Standards*. These standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

The GAO *Standards* require that internal controls be documented in management directives, administrative policies or operating manuals; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a timeframe that enables them to carry out their internal control procedures and other responsibilities.

*Recommendations:* We recommend that the Coast Guard:

1. Conduct an assessment of its current financial reporting process, including a review of its three general ledger systems, with the goal of establishing a general ledger that is FFMIA compliant at the transaction level, e.g., all financial transactions are recorded in the general ledger at the detail USSGL level as they occur, all financial statement line items are fully reconciled and supported by transactional detail contained in the general and subsidiary ledgers, reducing complexity, implementing appropriate internal controls, improving financial systems integration and automating manual processes;
2. Establish new or improve existing policies, procedures, and related internal controls to ensure that:
  - a) The year-end, close-out process; reconciliations; and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;
  - b) On-top adjustments to account balances and abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations are identified, reviewed and documented;
  - c) Account reconciliations, for each of the three general ledgers and the monthly TIER submission, are performed timely and completely each month, and differences are researched and resolved before the next month's reporting cycle. Reconciliations should include all funds maintained by the Coast Guard, including revolving, special, and trust funds;
  - d) The Coast Guard identifies all accounts receivables and then implements comprehensive Coast Guard-wide policies and procedures, including internal controls, at a sufficient level of detail to determine that the accounts receivable process is effective to support management assertions, in compliance with generally accepted accounting principles, for the accounts receivable balance reported on the Coast Guard balance sheet; and
  - e) The Coast Guard develops and implements effective policies, procedures and internal controls to compile, support, review, and report financial statement disclosures submitted for incorporation in the DHS financial statements, to include the effective completion the GAO Disclosure Checklist and valid support for the preparation of statement of net cost disclosure;
3. Investigate potential financial system problems such as potential posting logic errors and automated changes to financial data through scripts (system modifications); and
4. Establish a formal documented review and approval process over reconciliation activities performed by Coast Guard to ensure that all intragovernmental activity and balances are identified and differences are being resolved in a timely manner in coordination with the OFM (see Exhibit II-B, *Financial Reporting*). Procedures should also include obtaining positive confirmation of balances with DHS trading partners and make appropriate system



**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

changes to include updating and validating the information in the vendor tables for trading partner data, and correct known errors.

**I-C Financial Systems Security**

*Background:* The Coast Guard maintains three general ledger systems that support its financial statements and other financial data provided to DHS OFM for consolidation, which are CAS, ALMIS, and NESSS – described in Exhibit I-B, *Financial Reporting*. Our audit included a review of the Coast Guard's IT general control (ITGC), and specifically in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. During FY 2007, the Coast Guard took actions to improve aspects of its ITGC to address our prior year findings; however, the Coast Guard did not make all of the necessary improvements that they had planned to make during the year. The Coast Guard also serves as Transportation Security Administration's (TSA)'s accounting service provider; therefore, some financial accounting system and process weaknesses at the Coast Guard may affect the TSA's accounting records, as well.

*Conditions:* During our 2007 ITGC testing, we identified 42 findings, of which 36 are repeat findings and 6 are new findings. The ITGC and other financial system control weaknesses were identified at Coast Guard Headquarters and its components. We noted control deficiencies in all six general control areas that when combined, present more than a remote possibility of materially impacting financial data integrity. The significant deficiencies identified included: 1) excessive access to key Coast Guard financial applications, 2) application change control processes that are not adequately designed nor operating effectively, 3) entity-wide security program issues involving personnel background checks, 4) system software weaknesses involving patch management and configuration management, 5) segregation of duties involving lack of policies and procedures and excessive privilege access issues, and 6) service continuity issues involving the lack of testing of disaster recovery testing. Significant deficiency Nos. 1 and 2, above, are considered to be material weaknesses impacting the DHS consolidated financial statements. In addition, the significant deficiencies in application change control processes are among the principle causes of Coast Guard's inability to support their financial statement balances. See Exhibit I-B, *Financial Reporting*, for a discussion of the related conditions causing significant noncompliance with the requirements of FFMIA. Our ITGC findings are described in greater detail in a separate *Limited Official Use* (LOU) letter provided to the Coast Guard and DHS management.

*Cause/Effect:* The Coast Guard has made some progress correcting certain ITGC weaknesses identified in previous years. However, the Coast Guard was not able to effectively prioritize and implement CAPs to remediate the root cause of the ITGC weaknesses in 2007. Consequently, the corrective actions taken more often address the symptom of the problem and not the root cause. For example, workarounds are sometimes implemented so that the system can continue functioning, while more permanent solutions are developed.

Many of these weaknesses were inherited from system development activities that did not incorporate strong security controls during the initial implementation of the system more than five years ago, and will take several years to fully address. These weaknesses exist both in the documentation of processes and the implementation of adequate security controls over processes and within financial systems. Specifically, policies and procedures supporting the operation of various processes within control areas such as change control and access controls were developed without taking into account required security practices. Consequently, as policies and procedures

**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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are updated, many Coast Guard components are challenged to move away from previous methodologies and fully implement and enforce these new controls in unison with other components.

The effect of these ITGC weaknesses limits Coast Guard's ability to ensure that critical financial data is reliable and is maintained in a manner to ensure confidentiality, integrity, and availability. In addition, as a result of the presence of IT weaknesses, there is added dependency on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk of human error that could materially affect the financial statements.

*Criteria:* The *Federal Information Security Management Act* (FISMA) passed as part of the *Electronic Government Act of 2002*, mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources*, describe specific essential criteria for maintaining effective general IT controls.

FFMIA sets forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is 1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, 2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, 3) increase the accountability and credibility of federal financial management, 4) improve performance, productivity and efficiency of Federal Government financial management, and 5) establish financial management systems to support controlling the cost of Federal Government.

OMB Circular No. A-123 states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs." This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FFMIA. This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities for which it performs for others on a yearly basis. These controls shall be highlighted in management's annual assurance statement that is provided to its customers (e.g., TSA). Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

DHS' *Sensitive Systems Policy, 4300A*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems including the Coast Guard IT systems.

The GAO's *Federal Information System Controls Audit Manual* (FISCAM) provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

*Recommendations:* We recommend that the DHS Office of Chief Information Officer in coordination with the Office of the Chief Financial Officer (OCFO) make the following improvements to the Coast Guard's financial management systems:

**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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1. Implement the recommendations in our LOU letter provided to the Coast Guard and DHS management, to effectively address the deficiencies identified including: 1) access to key Coast Guard financial applications, 2) application change control processes, 3) entity-wide security program issues, 4) system software weaknesses involving patch management and configuration management, 5) segregation of duties involving lack of policies and procedures and excessive privilege access issues, and 6) service continuity issues involving the lack of testing of disaster recovery;
2. Design and implement plan of action and milestones that address the root cause of the weakness, to migrate away from excessive workarounds and reliance on manual mitigating controls; and
3. Develop and implement policies and procedures that appropriately consider required security practices when supporting the operation of various processes within control areas such as change control and access controls.

**I-D Fund Balance with Treasury**

*Background:* In fiscal year 2006, we reported the existence of a material weakness in Fund Balance with Treasury (FBwT) at the Coast Guard. The Coast Guard has not yet developed or implemented comprehensive FBwT CAPs, and consequently, we are repeating and expanding the conditions cited in last year's report. FBwT at the Coast Guard totaled approximately \$5 billion, or approximately 10 percent of total DHS FBwT, at September 30, 2007. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, at September 30, 2007.

*Conditions:* The Coast Guard:

- Did not maintain adequate supporting documentation that validated the accuracy of all of its FBwT reconciliations and the clearing of suspense items, to include posting unsupported adjustments to the Coast Guard reported general ledger activity submitted to the Treasury, and to agree Coast Guard balances to Treasury records without supporting documentation.
- Did not have an effective process for accounting for suspense account transactions related to FBwT. The Coast Guard lacks documented and effective policies and procedures, to include internal controls, to support the completeness, existence, and accuracy of recorded and subsequently posted suspense account transactions. The Coast Guard continues to be unable to produce complete and accurate populations of suspense transactions.
- Was unable to provide validated military and civilian payroll data to support payroll transactions processed through the Coast Guard's FBwT, USSGL account No. 1010. The Coast Guard did not properly report and reconcile these transactions or maintain appropriate supporting documentation.

*Cause/Effect:* The Coast Guard has not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127 and the requirements of the *Joint Financial Management Improvement Program* (JFMIP), now administered by the *Financial Systems Integration Office* (FSIO), to fully support the fiscal year 2007 FBwT activity and balance at September 30, 2007. Failure to implement timely and effective reconciliation processes could increase the risk of fraud, abuse, undetected violations of appropriation laws, including instances of undiscovered



**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

*Anti-deficiency Act* violations, and mismanagement of funds, which could lead to inaccurate financial reporting and affects DHS' ability to effectively monitor its budget status.

*Criteria:* The *Treasury Financial Manual* (TFM) states, "Federal agencies must reconcile their USSGL account No.1010, and any related subaccounts, on a monthly basis (at minimum). Federal agencies must research and resolve differences between the balances reported on their general ledger FBwT accounts and balances reported in the *Government-wide Accounting* system (GWA). In addition, Section 803(a) of FFMIA requires that Federal financial management systems comply with 1) Federal accounting standards, 2) Federal system requirements, and 3) the USSGL at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

According to OMB Circular No. A-123, transactions should be promptly recorded, and properly classified and accounted for, in order to prepare timely and reliable financial and other reports. Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

*Recommendations:* We recommend that the Coast Guard:

1. Establish policies, procedures, and internal controls, including effective reconciliations and the use of a financial system that complies with federal financial system requirements, as defined in OMB Circular A-127, and the requirements of the JFMIP, to fully support the fiscal year 2007 FBwT activity and balance at September 30, 2007. These policies and procedures should allow the Coast Guard to:
  - a) Perform complete and timely FBwT reconciliations using the tools provided by Treasury GWA;
  - b) Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining documentation of periodic reconciliations of FBwT; and
  - c) Ensure payroll data, supporting payroll transactions processed through FBwT (account 1010), is properly maintained and available for audit testwork, as needed.

**I-E Capital Assets and Supplies**

*Background:* Property, plant, and equipment (PP&E) represents approximately 15.5 percent of total DHS assets, and the Coast Guard maintains more than 60 percent of all DHS PP&E, including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. Comprehensive policies and procedures are necessary to accurately and timely account for and report these assets. We reported in prior years that the Coast Guard has been unable to provide auditable documentation for certain categories of PP&E, due to a number of policy, control, and process deficiencies that will require several years to correct, and consequently, most of the conditions cited below have been repeated from our 2006 report, and have existed since the Department's inception in 2003.

Operating Materials and Supplies (OM&S) are maintained by the Coast Guard in significant quantities, and consist of tangible personal property to be consumed in normal operations to service marine equipment, aircraft, and other operating equipment. The majority of the Coast Guard's OM&S is physically located at either two Inventory Control Points (ICPs) or in the field.

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#### **Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

The Coast Guard's policy requires regularly scheduled physical counts of OM&S, which are important to the proper valuation of OM&S and its safekeeping. The conditions cited below for OM&S are based on findings reported in fiscal 2006, updated as necessary to reflect the conditions noted in fiscal year 2007.

*Conditions:* Coast Guard has not:

*Regarding PP&E:*

- Consistently applied policies and procedures to ensure appropriate documentation supporting PP&E acquisitions, and their existence, is maintained to support capitalized PP&E. In cases where original acquisition documentation has not been maintained, the Coast Guard has not developed and documented methodologies and assumptions to support the value of PP&E.
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), transfers from other agencies, disposals in its fixed asset system, and valuation and classification of repairable PP&E.
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail, e.g., serial number, to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system.
- Properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives for depreciation purposes, consistent with GAAP.

*Regarding OM&S:*

- Implemented policies, procedures, and internal controls to support the completeness, accuracy, existence, valuation, ownership, and presentation assertions related to the fiscal year 2007 OM&S and related account balances.
- Fully designed and implemented policies, procedures, and internal controls over physical counts of OM&S to remediate conditions identified in previous years.
- Properly identified (bar-coded or tagged) recorded OM&S.
- Established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.

*Cause/Effect:* PP&E policies and procedures are not appropriately designed, consistently followed, or do not include sufficient controls to ensure compliance with policy or to ensure complete supporting documentation is maintained and available for audit testwork. The fixed asset module of the Coast Guard's CAS is not updated for effective tracking and reporting of PP&E. The effect of these conditions is that the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.

Coast Guard management deferred correction of most OM&S weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout fiscal year 2007. Lack of comprehensive and effective policies and controls over the performance of physical counts, and appropriate support for valuation, may result in errors in the physical inventory process or inventory discrepancies that could result in financial statement misstatements.

**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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*Criteria:* Statement of Federal Financial Accounting Standard (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, requires that:

- PP&E is recorded at historical cost with an adjustment recorded for depreciation. In the absence of such information, estimates may be used based on a comparison of similar assets with known values or inflation-adjusted current costs; and
- PP&E accounts should be adjusted for disposals, retirements, and removal of PP&E, including associated depreciation.

According to OMB Circular No. A-123, transactions should be promptly recorded, and properly classified and accounted for, in order to prepare timely and reliable financial and other reports. Documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

FFMIA Section 803(a) requires each agency to implement and maintain a system that complies substantially with Federal financial management system requirements as stipulated in OMB Circular No. A-127. That Circular requires an agency's system design "to have certain characteristics that include consistent internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of the information."

According to GAO *Standards*, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Policies and procedures should be in place for this process. The FSIO publication, *Inventory, Supplies, and Material System Requirements*, states that "the general requirements for control of inventory, supplies and materials consist of the processes of receipt and inspection. An agency's inventory, supplies and materials system must identify the intended location of the item and track its movement from the point of initial receipt to its final destination." SFFAS No. 3, *Accounting for Inventory and Related Property*, states OM&S shall be valued on the basis of historical cost.

*Recommendations:* We recommend that the Coast Guard:

*Regarding PP&E:*

1. Improve controls and related processes and procedures to ensure that documentation supporting PP&E acquisitions, to include the CIP process and existence, including additions, transfers, and disposals, is maintained to support capitalized PP&E;
2. Implement processes and controls to record PP&E transactions accurately, consistently, and timely in the fixed asset system; record an identifying number in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and ensure that the status of assets is accurately maintained in the system;
3. Revise procedures for performing physical inventories of repairable items, to include procedures for resolving differences, and reporting results, to ensure that repairable PP&E is accurately and completely classified and recorded. Support the pricing methodology used to value repairable PP&E to ensure that balances, as presented in the financial statements, approximate amortized historical cost; and
4. Review policies and procedures to account for improvements and impairments to buildings and structures, capital leases, and identify proper useful lives for depreciation purposes in accordance with GAAP.

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### Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

#### Regarding OM&S:

5. Update OM&S physical count policies, procedures, and controls, and provide training to personnel responsible for conducting physical inventories, and include key elements of an effective physical inventory in the policies;
6. Consider adopting a system of bar-coding or tagging OM&S as a method of tracking usage and maintaining a perpetual inventory of OM&S on hand; and
7. Establish processes and controls to support the calculated value of OM&S to ensure accounting is consistent with GAAP.

#### I-F Actuarial and Other Liabilities

*Background:* The Coast Guard maintains pension, medical, and postemployment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. The Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the Coast Guard. The medical plan covers active duty, reservists, retirees/survivors and their dependents that are provided care at Department of Defense (DoD) medical facilities. The postemployment travel benefit program pays the cost of transportation for uniformed service members upon separation from the Coast Guard. Annually, participant and cost data is extracted by the Coast Guard from its records and provided to an actuarial firm as input for the liability calculations. The accuracy of the actuarial liability as reported in the financial statements is dependent on the accuracy and completeness of the underlying participant and cost data provided to the actuary. A combined unfunded accrued liability of approximately \$30 billion for the plans is reported in the DHS consolidated balance sheet at September 30, 2007.

The Coast Guard estimates accounts payable as a percentage of undelivered orders (UDOs) based on historical trends. As described in Exhibit I-G, *Budgetary Accounting*, reliable accounting processes surrounding the recording of obligations and disbursements, and tracking of UDOs, are key to the accurate reporting of accounts payable in the Coast Guard's financial statements.

The Coast Guard's environmental liabilities consist of two main types: shore facilities and vessels. Shore facilities include any facilities or property other than ships, e.g., buildings, fuel tanks, lighthouses, small arms firing ranges (SAFRs), etc.

The Coast Guard estimates its legal liabilities to include Oil Spill Liability Trust Fund claims, that are incorporated, and recorded, as part of the DHS legal liability on DHS financial statements.

*Conditions:* We noted the following internal control weaknesses related to actuarial and other liabilities. The Coast Guard does not:

- Have effective policies, procedures, and controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and postemployment benefit liabilities. Reconciliations between subsidiary and general ledger amounts for medical expenditures are not effective.
- Have effective policies, procedures and internal controls over the Coast Guard's process for reconciling military payroll recorded in the CAS general ledger to detail payroll records. Military personnel data changes, including changes in leave balances and payroll corrections, are not processed in the appropriate payroll and/or reporting periods, and



**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections.

- Use a reliable methodology to estimate accounts payable. The method used was not supported as to the validity of data, assumptions, and criteria used to develop and subsequently validate the reliability of the estimate for financial reporting.
- Support the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2007 recorded environmental liability account balance. The Coast Guard has not fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to vessels, shore facilities projects, lighthouses, and SAFRs.
- Use a reliable methodology to estimate their legal liabilities, to include Oil Spill Liability Trust Fund claims that are incorporated and recorded as part of the DHS contingent legal liability on DHS consolidated financial statements. The Coast Guard did implement corrective actions to support the completeness of their oil spill legal claims. However, Coast Guard policies, procedures, and internal controls were not fully effective to accurately estimate liabilities for oil spill claims.

*Cause/Effect:* Much of the data required by the actuary comes from personnel and payroll systems that are outside of the Coast Guard's accounting organization and are instead managed by Coast Guard's Personnel Service Center (PSC). The PSC has not substantiated the completeness and accuracy of the basic pay information provided to the actuary. Consequently, the Coast Guard management is unable to provide assurance on the completeness and accuracy of actuarially determined liabilities as stated in the DHS consolidated balance sheet at September 30, 2007. In addition, the Coast Guard does not have sufficient controls to prevent overpayments for medical services, and inaccurate medical costs submitted to the Coast Guard actuary could result in a misstatement of the actuarial medical liability and related expenses. Also, the conditions noted exist, in part, because of ineffective entity-level controls, in particular, with regard to financial management oversight – see Exhibit I-A, *Financial Management and Entity Level Controls*.

The Coast Guard has not yet developed comprehensive policies and procedures or corrective action plans to address the conditions above, and consequently, management is unable to assert to the accuracy and completeness of accounts payable, and payroll accruals recorded as of September 30, 2007.

The Coast Guard has not developed consistent, written, agency-wide policies to define the technical approach, cost estimation methodology, and overall financial management oversight of its oil spill claims and environmental remediation projects, resulting in the inability to support the completeness of the estimate and possible misstatement of the liability in its financial statements.

*Criteria:* According to SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, paragraph 95, the employer should recognize an expense and a liability for other postemployment benefits (OPEB) when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. Further, the long-term OPEB liability should be measured at the present value of future payments, which requires the employer to estimate the amount and timing of future payments, and to discount the future outflow over the period for which the payments are to be made.

GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. OMB Circular No. A-123 states that "transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable

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financial and other reports.” SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, states, “When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.”

Statement on Auditing Standards (SAS) No. 57, *Auditing Accounting Estimates*, states “An entity’s internal control may reduce the likelihood of material misstatements of accounting estimates. Specific relevant aspects of internal control include the following: Accumulation of relevant, sufficient, and reliable data on which to base an accounting estimate, and comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates.”

Federal Accounting Standards Advisory Board (FASAB) Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. Probable is related to whether a future outflow will be required. Reasonably estimable relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required.

*Recommendations:* We recommend that the Coast Guard:

*Regarding actuarial liabilities:*

1. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of the actuarial pension, medical, and postemployment travel benefit liabilities;
2. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and postemployment travel benefit liabilities; and
3. Perform a periodic reconciliation between the medical expenditures recorded in the subsidiary ledger and those recorded in the CAS, and address differences before data is provided to the actuary. This reconciliation should be performed for all significant sources of medical actuarial data, including TriCare, and DoD Military Treatment Facilities (MTFs). In addition, this reconciliation should be reviewed by someone other than the preparer to ensure accuracy.

*Regarding accounts payable and payroll:*

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting; and
5. Implement corrective action, including appropriately designed and implemented internal controls, to support the completeness, existence, and accuracy of changes in member personnel data records and military payroll transactions, and to include recorded accrued military leave and payroll liabilities.

**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard***Regarding environmental liabilities:*

6. Develop consistent written agency-wide policies, procedures, processes, and controls to ensure identification of and recording of all environmental liabilities, define the technical approach, cost estimation methodology, and overall financial management oversight of its environmental remediation projects. The policies should include:
  - a) Procedures to ensure the proper calculation and review of cost estimates for consistency and accuracy in financial reporting, including the use of tested modeling techniques, use of verified cost parameters, and assumptions;
  - b) Periodically validate estimates against historical costs; and
  - c) Ensure that detailed cost data is maintained and reconciled to the general ledger.

*Regarding legal liabilities:*

7. Develop, document, and implement a reliable methodology as well as formal policies and procedures, to include internal controls, to verify and support the accuracy of the legal liability estimate and related disclosures.

**I-G Budgetary Accounting**

*Background:* Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Each Treasury Account Fund Symbol (TAFS), with separate budgetary accounts, must be maintained in accordance with OMB and Treasury guidance. The Coast Guard has over 80 TAFS covering a broad spectrum of budget authority, including annual, multiyear, and no-year appropriations; and several revolving, special, and trust funds. In addition, the Coast Guard estimates accounts payable at year end as a percentage of UDOs based on historical trends. Reliable accounting processes surrounding obligations, UDOs and disbursements are key to the accurate reporting of accounts payable in the DHS consolidated financial statements.

*Conditions:* We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our fiscal year 2006 report.

- The policies, procedures and internal controls over the Coast Guard's process for validation and verification of UDO balances are not effective to ensure that recorded obligations and UDO balances were complete, valid, accurate, and that proper approvals and supporting documentation is maintained.
- Policies were not fully implemented to ensure that contract awards, particularly related to the Deepwater Acquisition Program, were recorded in the general ledger in a timely manner, and as a result, obligations might have been temporarily understated.
- Procedures and controls are not implemented to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts. In addition, the Coast Guard did not effectively monitor unobligated commitment activity in its procurement system. As of April 2007, there were over 16,000 unobligated commitment transactions totaling approximately \$516 million.
- The Coast Guard's procedures, processes, and internal controls in place to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations were not properly designed and implemented. These deficiencies

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affected the completeness, existence, and accuracy of the year-end “pipeline” adjustment that was made to record obligations executed before year end.

- Automated system controls are not effectively used to prevent the processing of procurement transactions by contracting officer's with expired warrant authority, and a manual compensating control was not effective since listings of warranted contracting officers were not complete.

*Cause/Effect:* Several of the Coast Guard's budgetary control weaknesses can be corrected by modifications or improvements to the financial accounting system, process improvements, and strengthened policies and internal controls. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard could violate the *Anti-deficiency Act* and overspend its budget authority. The financial statements are also at greater risk of misstatement. The untimely release of commitments may prevent funds from being used timely for other purposes.

*Criteria:* According to the JFMIP, *Core Financial System Requirements*, an agency's core financial management system must ensure that an agency does not obligate or disburse funds in excess of those appropriated and/or authorized and specific system edits and user notifications related to funds control must be in place. The *Federal Acquisition Regulation* (FAR) Section 1.16 addresses the authorities and responsibilities granted to contracting officers. Treasury's USSGL guidance specifies the accounting entries related to budgetary transactions.

FFMIA Section 803(a) requires that each Agency to implement and maintain a system that complies substantially with Federal financial management system requirements as stipulated by OMB Circular No. A-127.

*Recommendations:* We recommend that the Coast Guard:

1. Improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Fully implement policies and the design and effectiveness of controls to ensure that contract awards are recorded in the general ledger in a timely manner;
3. Improve segregation of duties for transactions related to the creation and approval of purchase requisitions, certification of funds availability, and the recording of the obligations, and record contracts timely;
4. Revise controls and related policies and procedures to periodically review commitments;
5. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations for financial reporting; and
6. Establish automated system controls to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts and preclude the processing of procurement transactions if the contracting officer's warrant authority had expired.



**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components****II-A Financial Management and Entity Level Controls (FEMA)**

*Background:* The Federal Emergency Management Agency (FEMA)'s accounting and financial reporting requirements are very diverse supporting multifaceted operations, such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. These programs are sometimes subject to complicated accounting rules, as defined by the *Federal Accounting Standards Advisory Board* (FASAB), and require specialized technical knowledge to interpret and apply. FEMA has been subject to significant reorganization efforts during FY 2007 and FY 2006, while also continuing its disaster relief efforts resulting from the 2005 hurricanes affecting the Southern U.S. In addition, FEMA's accounting personnel and systems need to be ready to mobilize and support disaster operations with little advance notice, while also maintaining sound financial management standards. These circumstances place a high demand on financial management and emphasize the need for strong entity level controls throughout FEMA. Some of the conditions cited below contributed to qualifications of our Independent Auditors' Report in previous years. We believe these conditions, which include financial reporting control weaknesses, considered in aggregate, now represent a material weakness in financial management and entity level controls at FEMA.

|      | 2007 | 2006 | 2005 |
|------|------|------|------|
| FEMA | MW   | N/A  | N/A  |
| OFM  | C    |      |      |
| ICE  | C    |      |      |

**Key – Trend Table**

|    |                         |
|----|-------------------------|
| C  | Corrected               |
| SD | Significant Deficiency* |
| MW | Material Weakness*      |

\* See Introduction

Until 2007, the DHS OFM, within the OCFO at DHS Headquarters has not been adequately staffed with a sufficient number of management personnel who had the requisite financial accounting background, knowledge, and expertise, to both (i) set up, and (ii) effectively manage the consolidated financial reporting and internal control infrastructure of a large and complex Executive Branch agency. However, late in FY 2006 and throughout 2007, the OCFO executed a staffing plan to fill gaps in OFM skill sets. With the addition of new financial management and staff, restructuring of the OFM, development and issuance of new policies and procedures, and improved internal controls, with a focus on entity level controls, we noted that OFM has fully corrected its material weakness in *Financial Management and Entity Level Controls* reported in our FY 2006 report.

In 2006, we reported that ICE corrected its entity level control weaknesses in financial management and oversight. The corrective actions taken in 2006 continued to be effective in FY 2007.

*Conditions:* We noted the following internal control weaknesses related to financial management and entity level controls at FEMA, when combined with the conditions existing at the Coast Guard (see Exhibit I-A, *Financial Management and Entity Level Controls*), rise to a material weakness at the DHS consolidated financial statement level.

**FEMA:**

- Has not established a financial management organizational structure, with clear oversight and supervisory review functions that supports the development and implementation of effective policies, procedures, and internal controls over financial reporting, to ensure that accounting principles are correctly applied and accurate financial data is submitted to OFM for consolidation in a timely manner. For example, we noted:

**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

- The FEMA CFO does not have clearly defined and complete authority and responsibility for all financial accounting policy, processes, and control functions throughout the agency;
- Financial management oversight functions have not been clearly defined, complete with an organizational chart, job descriptions, roles and responsibilities, training requirements, and skill sets required;
- A lack of segregation of duties in financial reporting roles; and
- A lack of supervisory review in financial functions, especially over complex, nonroutine accounting estimates and adjustments, such as credit reform subsidies.
- Does not have a sufficient number of experienced financial managers and staff to expeditiously address nonroutine accounting issues. A lack of skilled accounting resources has contributed to FEMA's inability to perform important accounting functions timely. For example, we noted that FEMA did not:
  - Fully integrate certain Grants and Training (G&T) accounting processes;
  - Perform necessary procedures to completely and accurately present stockpile inventory balances in the consolidated financial statements;
  - Reevaluate the reasonableness of its allowance rates for disaster relief accounts receivable; and
  - Prepare and record adjustments for its National Flood Insurance Program accurately or timely. A material error was identified after submission of FEMA's year-end financial information to OFM.
- Has not completed and implemented a comprehensive CAP to correct internal control weaknesses that are contributing to Department-level material weaknesses, as required by OMB Circular No. A-50, *Audit Follow-up*, as revised.
- Has not documented and/or updated formal policies and procedures (including desk manuals) for many of the roles, responsibilities, processes, and functions performed within FEMA. For example, in FY 2007, we noted that improvements are needed in the formal documentation of policies and procedures related to *Anti-deficiency Act* compliance, preparation and review of the quarterly and annual financial statements; identification of and adherence to GAAP and OMB statements and guidance; policies for timely de-obligation of outstanding grant and non-grant obligations that should be closed related to the former G&T office; policies for monitoring and responding to OMB Circular No. A-133 reports, Office of Inspector General (OIG) reports, and GAO report findings and recommendations; and the quarterly process for estimating accruals (including accrual validation).
- Has not completed the placement of sufficient financial and accounting resources in its regional offices, which contributes to certain issues in Mission Assignment accounting. For example, Mission Assignment obligations are not closed out timely, and in a sample of 216 Mission Assignment payments selected for testwork, we noted that approximately 10% of the payments were not properly reviewed and approved in accordance with FEMA policy.

*Cause/Effect:* FEMA maintains a relatively small headquarters infrastructure and accounting staff, compared to its diverse programmatic and mission focused objectives. In addition, FEMA is dependent on timely information from other federal agencies, state governments, and grantees

**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

to account for some transactions. FEMA's evaluation of internal control over financial reporting conducted pursuant to OMB Circular No. 123, *Managements Responsibility for Internal Control*, and representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, stated that FEMA could not provide reasonable assurance that its internal controls over financial reporting are operating effectively to achieve desired objectives during FY 2007.

*Criteria:* FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the *GAO Standards*. The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The *GAO Standards* identify the control environment, as one of the five key elements of control, which emphasizes the importance of control conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, and segregation of duties, policies, procedures, and monitoring.

*Recommendations:* We recommend that FEMA:

- a) Provide its CFO with clear authority to develop and implement accounting and financial reporting policies, procedures, and internal controls throughout the agency. Program offices should be required to adhere to policies;
- b) Evaluate the existing financial management organizational and internal control structure to determine the number of personnel and resources needed, along with the requisite skills and abilities necessary, to ensure that all significant transactions and account balances are accurately and completely recorded in FEMA's general ledger in a timely manner;
- c) Assign accounting functions and responsibilities to staff to ensure proper segregation of duties;
- d) Establish clear management oversight responsibilities and processes to effectively review adjustments to account balances and complex, nonroutine accounting transactions;
- e) Develop and implement a comprehensive CAPs to correct conditions that contribute to the Department-level material weaknesses in internal controls, and prevented FEMA management from providing reasonable assurance on the effectiveness of internal control;
- f) Fully implement plans to place comptrollers in each regional office; and
- g) Ensure that procedures are in place to maintain all job-related training, and other critical personnel actions.

**II-B Financial Reporting (DHS-HQ, FEMA, and TSA)**

*Background:* DHS-HQ (or DHS Management and Operations) is comprised of various programs, reporting entities, and offices including, the OCFO. The OCFO is primarily responsible for the financial accounting and reporting infrastructure of the Department, together with other responsibilities as defined in the *Chief Financial Officers Act of 1990*, as amended by *DHS Financial Accountability Act of 2004*. DHS' OFM is responsible for preparing the *Annual Financial Report (AFR)*, including the

|        | 2007 | 2006 | 2005 |
|--------|------|------|------|
| DHS-HQ | MW   |      |      |
| FEMA*  | MW   | N/A  |      |
| TSA    | SD   |      |      |
| ICE    | C    | C    |      |

\* FEMA Financial Reporting conditions are combined with Comment II-A in 2007

**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

consolidated financial statements, footnote and supplementary data, from trial balances and other financial data submitted by the components to OFM through the TIER system. DHS components are responsible for providing OFM complete, accurate, and timely submission of monthly financial data and reports. The DHS CFO has authority to establish accounting policy that must be followed by components when submitting data used in the DHS consolidated financial statements, and has established *Standard Operating Procedures* (SOPs), to perform oversight and monitoring controls over financial data submitted by the components that are properly designed and effective when fully completed. During FY 2007, the OCFO issued a component guide that describes component reporting procedures and requirements, as well as other policy memoranda, and several additional DHS-wide policies are scheduled for release in 2008.

FEMA identified a material weakness in internal control over financial reporting in its FY 2007 assurance statement sent to the Secretary, in accordance with Departmental policies requiring self evaluation of internal controls pursuant to FMFIA and OMB Circular No. A-123. The financial reporting internal control weaknesses at FEMA are included in Exhibit II-A, *Financial Management and Entity Level Controls*.

The TSA began using the Coast Guard's *Core Accounting System* (CAS) for its primary general ledger in FY 2005. The transition to a new accounting system required the development and implementation of many new accounting processes and procedures, some of which were needed to mitigate material weaknesses in internal controls that existed prior to TSA's migration to CAS and that currently exist at the Coast Guard. This process of setting up a financial accounting and reporting process interfered with TSA's ability to prepare timely and accurate financial statements through 2006, and contributed to a material weakness in internal controls over financial reporting. In FY 2007, TSA developed and implemented a CAP to address its financial reporting and other accounting internal control weaknesses. TSA has made progress toward correction of control weaknesses in financial reporting in FY 2007.

In 2006, we reported that ICE corrected its internal control weaknesses over financial reporting. The corrective actions taken in 2006 continued to be effective in FY 2007.

*Conditions:* We noted the following internal control weaknesses related to financial reporting at DHS-HQ and TSA:

1. DHS-HQ:

- Has made significant progress toward the performance of responsibilities related to the consolidated financial reporting at DHS, however additional improvements are needed to fully implement a consolidated financial reporting process. This condition is supported, in part by these observations:
  - As part of the Post-Katrina reorganization, the Office of Health Affairs (OHA) was established. The accounting, reporting, and data gathering responsibilities for the new entity, including a new reporting requirement affecting the presentation of a transfer appropriation account and related activity conducted by another Federal agency and reimbursed by OHA, were not clearly established and delegated in time to be effective during the year. OHA does not have the administrative infrastructure in place to facilitate (i.e., user controls) financial reporting functions provided by its service provider (i.e., service provider controls) which changed during FY 2007. Consequently, DHS management was unable to support its implementation of a new reporting requirement of OMB Bulletin No. A-136, *Financial Reporting Requirements*, affecting the accounting and presentation of budgetary allocation transfers that occurred at OHA, and was unable to represent that the balance sheet of



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OHA is fairly stated in conformity with U.S. generally accepted accounting principles at September 30, 2007. Specifically, OHA did not obtain assurance that \$1.4 billion of fund balance with Treasury and undelivered orders recorded as result of a budget allocation to another Federal agency, was properly stated at September 30, 2007. The total assets of OHA, as reported in the accompanying DHS balance sheet as of September 30, 2007, were \$3.2 billion or 4 percent of total DHS consolidated assets.

- DHS was not able to timely or completely reconcile intragovernmental balances with other Federal entities, particularly the Department of Defense. Consequently, the DHS' *Material Difference/Status of Disposition Certification Report*, submitted to the Treasury for September 30, 2007, showed material differences attributable to accounting/reporting errors in excess of \$1.5 billion FEMA, Coast Guard, TSA and CBP are DHS components that have significant intragovernmental transactions throughout the year. These conditions also impacted DHS' ability to accurately report transactions with Federal government trading partners in the financial statements as required; and
- Instances were noted where DHS components routinely provided OFM incomplete or inaccurate information, and/or did not respond timely to OFM' inquiries. Consequently, OFM was often unable to fully complete its own procedures for timely review of component financial data and, therefore, are unable to resolve potential errors before the financial statements were prepared.
- Has not fully implemented recently issued policies, and we noted weaknesses in the operating effectiveness of the following established policies:
  - Beginning of the year balance reconciliations that ensure opening balances agree to the prior year ending balances. These weaknesses resulted in several material errors in the financial statements that were not identified by OFM, until questioned during our audit;
  - Interim financial statement preparation and support. During our review of the June 30, 2007, draft financial statements, we noted some errors and discrepancies that were not corrected prior to submission to the auditor. In some cases, we noted that erroneous entries were recorded to correct out-of-balance conditions in data submitted by components, without support or follow-up, and resolution with the component; and
  - Computation of abnormal or unusual account balances, including proprietary to budgetary account relationship analysis performed at the consolidated level. Currently, there is still a reliance on the external auditor to identify potential errors through proprietary to budgetary reconciliations, and refer the differences to components and OFM for investigation and resolution. Although upgrades to the existing analytical tools have been developed by OFM, they are not yet being fully utilized, with full implementation scheduled for FY 2008.
- Did not always perform key supervisory and monitoring control procedures over work prepared by accounting staff during the year. In some cases, we noted that supervisory reviews were performed and documented on incomplete information, without evidence of closure on open issues. Some reviews were not effective, e.g., did not identify material errors in the financial data. For example, some top-side (manual) adjustments to financial statements, and fluctuation and variance analysis, were not always reviewed and approved by a supervisor. In some cases, we noted that these manual adjustments also created misstatements of the financial statement balances, which were identified during our audit.

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- Has not established Strategic Goals and the financial information systems or sufficiently documented processes to accumulate cost data by DHS strategic goal when the goals are established, as required by SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, and does not have a current strategic plan, as required by the *Government Performance and Results Act* (GPRA) (see Exhibit III-N).
2. TSA has improved its financial reporting process in FY 2007. While TSA has made progress in addressing the conditions we identified and reported in 2006, its financial reporting CAP has not been fully implemented by the end of FY 2007. We noted that TSA:
- Made a number of restatements to its prior year financial statements, primarily as a result prior-year data that was not previously reconciled to its general ledger.
  - Did not have certain policies and procedures in place all fiscal year.
  - Required numerous other on-top adjustments to properly close and report its monthly and annual financial results, did not consistently reverse all on-top adjustments that required reversal, and did not record all on-top adjustments properly.
  - Required significant additional human resources, to perform its year-end general ledger close, prepare financial statements, and respond to audit inquiries in a timely manner.

*Cause/Effect:* The OCFO adopted CAPs to address the conditions cited above; however, we continue to report that the OCFO has a material weakness in financial reporting, primarily because the OCFO has not yet fully implemented policies designed to ensure timely, accurate, and complete periodic reporting throughout the year, and developed tools to ensure that component agencies routinely respond to inquiries and actively investigate and resolve potential accounting and reporting errors in a timely manner. In some cases, newly designed centralized policies and procedures, together with effective internal controls over financial reporting, have not been fully implemented as of September 30, 2007. In addition, challenges remain in obtaining consistently complete and accurate data from DHS components, affecting OFM's ability to completely perform its responsibilities in a timely manner.

Intragovernmental out-of-balances exist in many Federal agencies and DHS is dependent on other Federal agencies maintaining accurate account balances in order to fully reconcile its balances. No government-wide system currently exists to allow for this reconciliation to be done independently by DHS. Although OFM undertook numerous corrective actions in FY 2007, including initiating a consolidated confirmation process, holding workshops to instruct components how to reconcile balances, assisting components in implementing procedures to support balances with external trading partners, and meeting with OMB and other agencies to directly reconcile differences, DHS was not able to fully reconcile its balances. OFM's process does demonstrate progress; for instance, it recently reconciled a \$350 million difference with the Department of Defense.

TSA's CAP is a two-year plan to fully remediate the process and control weaknesses in financial reporting, which is not scheduled for completion until FY 2008. TSA invested substantial resources to reconcile its beginning balance sheet accounts, as necessary, to obtain an external audit of those accounts. FY 2007 was a "catch-up" year, intended to establish more efficient and effective accounting and financial reporting processes which will benefit FY 2008 and beyond.

*Criteria:* OMB Circular No. A-136, *Financial Reporting Requirements*, revised July 24, 2006, changed the financial reporting requirements for transferring, or allocating, budget authority from one entity to another within or to another Federal department (i.e., parent/child reporting). OMB Memorandum M-07-12 clarified the reporting requirements and emphasized that the two Federal

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departments may need to coordinate to ensure that parent's reporting and auditing requirements are met.

The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 18, 2006, and OMB Circular No. A-136, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2006, Vol. I, Part 2-Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements*, requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03 *Intragovernmental Business Rules*, also provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities.

OMB Circular No. A-123 defines management's responsibility and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. Within the organizational structure, management must clearly: define areas of authority and responsibility; appropriately delegate the authority and responsibility throughout the agency; establish a suitable hierarchy for reporting; support appropriate human capital policies for hiring, training, evaluating, counseling, advancing, compensating, and disciplining personnel; and uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties as well as understand the importance of maintaining effective internal control within the organization.

FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the *GAO Standards*. The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The *GAO Standards* identify the control environment, as one of the five key elements of control, which emphasizes the importance of control conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, and segregation of duties, policies, procedures, and monitoring.

OMB Circular No. A-50 states that corrective action taken by management on audit findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

*Recommendations:* We recommend that:

1. DHS-HQ (with OCFO and OFM):

- a) Develop a strategy to quickly provide full accounting and reporting services to newly created reporting entities. Identify a full-service accounting provider for OHA, that will address the allocation transfer accounting matters early in FY 2008, and make appropriate adjustments to the financial statements to accurately reflect activity and balances. Consider creating a permanent group within OCFO that will proactively identify and resolve accounting issues before they develop into significant problems, similar to the process used to assist US-Visit in FY 2007. When appropriate, and needed, this group should be directly involved in development and implementation of long-term accounting solutions, either within the Directorate or at an existing component;
- b) Fully implement a comprehensive proprietary to budgetary account analysis that is performed each month with TIER submissions, and require component entities to

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investigate and resolve differences in a timely manner. Monthly certifications received from component CFOs should specifically state the completion of this procedures, together with recording of correcting entries to the general ledger;

- c) Direct component CFO leadership to improve communication and coordination on unique accounting and transactional matters, and to improve the accuracy of routine monthly data submissions. Problems with timeliness, completeness and accuracy of component data submissions, and/or responsiveness to OFM may need the support of the CFO to resolve;
- d) In coordination with other DHS components, further develop policies, procedures and controls that will result in the timely reconciliation of intragovernmental activity and balances. Differences should be reconciled in a timely manner. This may involve setting up special arrangements with some trading partners, such as work OFM has begun with the Department of Defense. Procedures should include positive confirmation at least on a quarterly basis, all intragovernmental activity and balances with their intragovernmental trading partners, including other DHS component entities, as prescribed by Treasury guidance;
- e) Continue with implementation of the financial reporting management directives scheduled for release in FY 2008. Once implemented, the policies should be tested for effectiveness, and when necessary, make improvement to addresses weaknesses identified;
- f) Improve supervisory and monitoring control procedures over work prepared by accounting staff during the year, to ensure that they will reliably identify errors for correction, in a timely manner. Consider additional training for component accountants to improve the quality of submitted financial data, and for desk officers to improve the effectiveness of their initial reviews; and
- g) OCFO and applicable component entities should develop financial information systems and document processes to accumulate and present cost data by DHS strategic goal, as required by SFFAS No. 4.

**2. TSA:**

- a) Consistently adhere to policies and perform procedures for the preparation and approval of on-top adjustments for submission to its accounting services provider;
- b) Develop and implement procedures to properly identify all on-top adjustments that require reversal in the subsequent period and to ensure the timely reversal of those adjustments; and
- c) Once accounting and reporting processes stabilize in FY 2008, perform a financial organization and human resource needs assessment in coordination with its accounting services provider to determine the optimum number of accounting personnel and skill sets required and the most effective organizational structure to sustain efficient accounting operations. TSA's accounting operations should be designed and staffed to most efficiently support timely responses to auditor inquiries during the year, without also causing significant disruption to on-going accounting operations.

**II-C Financial Systems Security**

*Background:* Financial systems security is essential to achieving effective, reliable reporting of financial and performance data. As a part of the financial statement audit, we perform an



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evaluation of the general controls over significant DHS financial IT systems. Effective general controls are typically defined by the GAO's FISCAM, in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. In addition to general controls, financial systems contain application controls, which are the structure, policies, and procedures that apply to use, operability, interface, edit and monitoring controls of an application. We tested various application controls of key DHS financial systems as part of our IT audit test work.

The primary IT systems evaluated as a part of our audit are the component general ledger and subsidiary/feeder subledger or modules that support the financial statements and specific accounting processes such as grants, loans, excise tax receipts, etc.

During FY 2007, DHS Civilian Components took significant steps to improve their financial systems security, particularly the FISCAM general control areas entity-wide security program planning and management, and system software, which resulted in the closure of more than 30% of our prior year IT control findings.

*Conditions:* The FISCAM IT general control areas that continue to present a risk to financial systems security and data integrity include: 1) excessive access to key DHS financial applications; 2) application change control processes that are inappropriate in other locations not fully defined, followed, or effective; and 3) service continuity issues impacting DHS' ability to ensure that DHS financial data is available when needed. The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to ensure confidentiality, integrity, and availability. Our findings, including significant deficiencies that do not rise to the level of being a material weakness, are described in greater detail in a separate *Limited Official Use* letter provided to DHS management.

*Regarding access controls – we noted:*

- Excessive access existed within financial applications at two DHS components. Specifically, instances of generic shared accounts exist on the financial applications. These accounts have every privilege within the application, including the ability to create/delete/modify user accounts.
- Account management documentation did not exist, and user account lists were not periodically reviewed for appropriateness, resulting in inappropriate authorizations and excessive user access privileges across two DHS components.
- Accounts were not configured to disable upon personnel termination across two DHS components.
- Two DHS components had a large number of instances of inadequate or weak passwords that existed on key servers and databases that house financial data.
- Instances where workstations, servers, or network devices were configured without necessary security patches, inactivity time-outs, and proactive/appropriate vulnerability scanning not occurring.
- Audit logs were not reviewed at one DHS component, and the most restrictive security settings for the audit logging of highly privileged accounts and the protection of data sets were not enabled for a financial application at another DHS component.

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*Regarding application software development and change control – we noted:*

- Instances where changes made to the configuration of the system were not always documented or performed for test plans, test results, approvals or software modifications at two DHS components. Additionally, documented approval did not exist, or was not always retained, for emergency enhancements, “bug” fixes, and data fixes, and in some cases, audit logs for tracking changes to the data or systems were not activated.
- One DHS component had implemented a separate and secondary change control process outside of and conflicting with the established change control process. In another instance, changes were made prior to management approval. Instances where changes made to the configuration of the system were not always documented or performed through System Change Requests (SCRs), test plans, test results, approvals, or software modifications at two DHS components also existed.
- The contract that a DHS component has with the software vendor does not include security configuration requirements that must be adhered to during the configuration management process.
- Instances where policies and procedures regarding change controls were not in place to prevent users from having concurrent access to the development, test, and production environments of the system, or for restricting access to application system software and system support files.
- Policies and procedures surrounding the system development life cycle (SDLC) process have not been documented or adopted a finalized SDLC.

*Regarding service continuity – we noted:*

- The Continuity of Operations Plan (COOP) does not include an accurate listing of critical information technology systems, did not have critical data files and an alternate processing facility documented, and was not adequately tested for DHS one component. An alternate processing site is not operational for DHS one component.
- Backup tapes are not rotated off site or are not periodically tested. One DHS component did not have policy and procedures developed for testing of backups.
- Rules of Behavior forms are not consistently signed prior to gaining local area network (LAN) access for one DHS component.

*Cause/Effect:* Many of these weaknesses were inherited from the legacy agencies that came into DHS or system development activities that did not incorporate strong security controls from the outset and will take several years to fully address. A contributing cause to repeated findings is that DHS lacks an effective component-wide prioritization of IT systems issues, including the development of a stable centralized IT platform for the Department. Several attempts have been made, such as eMerge and eMerge 2, to centralize the financial IT platform; however, each has been halted or delayed. In addition, we found that focus is also placed on the tracking of response to audit recommendations, instead of on developing the most effective method of addressing the actual control weakness; and when weaknesses in controls or processes are identified, the corrective actions address the symptom of the problem and do not the correct root cause – amounting to a temporary fix.

The effect of the IT weaknesses identified during our testing impacts the reliability of DHS' financial data. Many of these weaknesses, especially those in the area of change controls, may result in material errors in DHS' financial data that are not detected, in a timely manner, in the

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normal course of business. In addition, as a result of the presence of IT weaknesses there is added pressure on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk of human error that could materially affect the financial statements.

*Criteria:* The FISMA passed as part of the *E-Government Act of 2002*, mandates that Federal entities maintain IT security programs in accordance with NIST guidance.

OMB Circular No. A-130 describes specific essential criteria for maintaining effective general IT controls.

FFMIA set forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is: (1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government.

DHS' *Sensitive Systems Policy, 4300A*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

The FISCAM provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

*Recommendations:* We recommend that the DHS Office of Chief Information Officer in coordination with the OCFO make the following improvements to the Departments financial management systems:

*For access controls:*

- a) Implement an account management certification process within all the components to ensure the periodic review of user accounts for appropriate access and to ensure that generic accounts do not exist on the system;
- b) Implement and appropriately implement an access authorization process that ensures that a request is completed and documented for each individual prior to granting him/her access to a financial application or database;
- c) Implement a process to ensure that all accounts of terminated individuals from the system are immediately removed/end-dated/disabled upon their departure. This includes both terminated employees and contractors;
- d) Enforce password controls that meet DHS' password requirements on all key financial systems. Conduct periodic vulnerability assessments, whereby systems are periodically reviewed for access controls not in compliance with DHS and Federal guidance and ensure that action is taken to remediate any security weaknesses identified;
- e) Implement a patch and security configuration process, and enforce the requirement that systems are periodically tested by DHS components and the DHS Office of Chief Information Officer; and

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- f) Develop and implement detailed procedures requiring the review of operating system logs for suspicious activity and conduct audit log reviews of the operating system on a consistent and timely basis.

*For application software development and change control:*

- a) Further develop and enforce policies that require changes to the configuration of the system are approved and documented, and audit logs are activated and reviewed on a periodic basis;
- b) Implement a single, integrated change control process over the DHS components' financial systems with appropriate internal controls to include clear lines of authority to the components' financial management personnel and to enforce responsibilities of all participants in the process and documentation requirements. Further develop and enforce policies that require changes to the configuration of the system are approved and documented, and audit logs are activated and reviewed on a periodic basis;
- c) Reevaluate and revise the contract between DHS and the software vendor or otherwise ensure that the security configurations associated with the application changes and software patches are in compliance with DHS and NIST standards for financial applications;
- d) Develop and implement formal policies and procedures for restricting access to DHS system software, and promulgate it to all needed personnel, to be in compliance with DHS *Sensitive Systems Policy*, 4300A;
- e) Develop and implement procedures to perform a periodic review of access to financial application software and support files to determine whether access is valid, consistent with job responsibilities, and according to the least privilege principle; and
- f) Remove excessive access to the all DHS financial application software and support files. Develop, document and implement a formalized SDLC process.

*For service continuity:*

- a) Update the COOP to document and prioritize an accurate listing of critical IT systems;
- b) Perform testing of key service continuity capabilities, including contingency planning;
- c) Ensure that the alternate processing site is made operational;
- d) Rotate backups off-site on a regular basis, implement policies and procedures developed to enforce testing of backups, and Test backups at least annually;
- e) Revise the COOP to incorporate critical data files and alternate processing facility; and
- f) Ensure that all employees and contractors acknowledge and sign a Rules of Behavior prior to being granted LAN access.

**II-D Not Used****II-E Capital Assets and Supplies (FEMA, TSA and US-Visit)**

*Background:* FEMA maintains a stockpile of inventory (e.g., blankets, bottled water, cots, tarps, plastic sheeting, Meals Ready to Eat, and ice), to be used for disaster relief if the need arises. After the 2005 hurricane season, FEMA substantially

|          | 2007 | 2006 | 2005 |
|----------|------|------|------|
| FEMA     | MW   | N/A  | N/A  |
| TSA      | SD   |      |      |
| US-Visit | SD   |      |      |



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increased the amount of supplies that are stockpiled. The large increase in supplies has also increased the asset's carrying value on FEMA's and DHS' financial statements. FEMA policies require the agency to conduct an annual inventory of the supplies.

TSA maintains extensive capital assets used at airports to screen passengers and their baggage. In FY 2006, we reported accounting process and control weaknesses at TSA related to, among other things, the unreconciled Property, Plant and Equipment (PP&E) balances, and the lack of supporting documentation needed to perform our audit. These conditions also prevented TSA from asserting that its September 30, 2006 PP&E was fairly stated. During FY 2007, TSA executed a CAP to correct these deficiencies. We noted that TSA corrected the deficiencies we reported in prior years by September 30, 2007.

The mission of US-Visit is to collect, maintain, and share information on foreign nationals traveling to and from the United States in order to enhance national security, facilitate legitimate trade and travel, and contribute to the integrity of our immigration system, while deploying the program in accordance with existing privacy laws and policies. Customized software is being developed to assist with this objective.

*Conditions:* We noted the following internal control weaknesses related to capital assets and supplies at FEMA, TSA and US-Visit:

## 1. FEMA:

- Did not fully adhere to its policies when performing its annual physical count of supplies inventory. We noted that:
  - Inventory counts were not fully reconciled to FEMA's Logistics Information Management System (LIMS), which is used to track inventory;
  - Inventory counts were not conducted in a well-controlled environment. We noted numerous weaknesses in how the procedures were conducted, which increased the likelihood of error; and
  - In some cases inventory that was in LIMS could not be located.
- Adjustments to the stockpile inventory were not recorded in FEMA's general ledger system as they occurred throughout FY 2007.

## 2. TSA:

- Did not reconcile its PP&E subsidiary ledger to its general ledger consistently and timely throughout FY 2007. However, TSA was reconciling timely by year-end.
- Has not recorded depreciation on certain explosive detection equipment, using a method that is consistent with generally accepted accounting principles. Specifically, TSA began recording depreciation expense prior to the date the equipment was placed in service. Consequently, TSA has recorded excessive depreciation expense during FY 2007 and in previous years totaling approximately \$80 million. TSA recomputed the depreciation expense, using the correct date placed in service, and adjusted its PP&E, depreciation expense, and net position balances to correct the error in its FY 2007 financial statements. The adjustment also resulted in a restatement of TSA's 2006 financial statements.
- Uses USSGL Account No. 1890 (Other PP&E) to record all PP&E purchases, which is not compliant with the USSGL requirements of FFMIA.
- Improperly capitalized certain advance payments to vendors as construction in progress.

**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components****3. US-Visit:**

- Did not consistently apply procedures to identify and capitalize software development costs or to reclassify software placed into production from software in development; and
- Does not have a reliable financial accounting and reporting process or system in place to routinely account for its software expenditures, capitalize appropriate amounts, and report those balances to OFM to report in the consolidated financial statements.

*Cause/Effect:* FEMA personnel performing the physical count of supplies lacked training in proper inventory count procedures and failed to reconcile results to the LIMS database. Without accurate physical counts and reconciliations to the perpetual records, FEMA cannot be sure supplies exist, listings of available supplies are complete, and the financial statements accurately reflect the asset values. FEMA was unable to devote sufficient human resources to properly account for its stockpile during FY 2007 (see Exhibit II-A, *Financial Management and Entity Level Controls*).

TSA personnel considered that the date of purchase and receipt of the explosive detection equipment was a reasonable approximation of the date the asset was placed in service. Verification of the reasonableness of this accounting practice was not performed, and consequently the discrepancy was not discovered until our audit of capital assets this year. Because of insufficient accounting code details on purchase orders and related system configurations, TSA's accounting services provider (Coast Guard) records PP&E purchases that do not have sufficient accounting code details to USSGL Account No. 1890 until information is available to record such purchases in the appropriate capitalized PP&E or expense account.

US-Visit has developed adequate accounting policies for tracking software development costs, these policies are not fully or adequately implemented during FY 2007. With assistance from OFM, US-Visit was able to manually compute an estimated balance, which was reclassified to capitalized software at year end for financial statement presentation purposes. A lack of sufficient personnel assigned to the financial reporting areas of US-Visit appear to have contributed to implementation delays.

*Criteria:* SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, requires that PP&E is recorded at historical cost with an adjustment recorded for depreciation. Depreciation expense should be recognized in the financial statements beginning on the date that the asset is placed in service for its intended use.

According to GAO *Standards*, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Policies and procedures should be in place for this process. The FSIO publication, *Inventory, Supplies, and Material System Requirements*, states that the general requirements for control of inventory, supplies, and materials consist of the processes of receipt and inspection. An agency's inventory, supplies and materials system must identify the intended location of the item and track its movement from the point of initial receipt to its final destination. SFFAS No. 3, *Accounting for Inventory and Related Property*, states OM&S shall be valued on the basis of historical cost.

Per FEMA Manual 6150.1 Section 4-4g, *Annual Inventory of Accountable Property*, the designated Property Management Officers (PMO) will ensure that a complete physical inventory of FEMA property with acquisition cost of \$5,000 or more, sensitive items, serialized equipment, and loaned equipment is made annually, discrepancies reconciled, and the results maintained on file for one year. The annual inventory of accountable property may be wall-to-wall (closed), cyclic (open), or special (when directed). A wall-to-wall inventory is a complete counting of all items located within the organization as of a scheduled date. A cyclic inventory is the counting of

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a portion of the organization's property during a given period of time (monthly, quarterly, or semiannually) to cover the entire account in a one-year period. A special inventory is the counting of selected items for a specific reason.

SFFAS No. 10, *Accounting for Internal Use Software*, provides requirements for the capitalization and reporting of software development costs. GAO *Standards* require that internal control and all transactions and other significant events be clearly documented and readily available for examination. The JFMIP, *Property Management Systems Requirements*, state that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donator, lender, grantor, etc.).

*Recommendations:* We recommend that:

1. FEMA:
  - a) Devote necessary personnel to develop and implement proper accounting policies and procedures and related internal controls to ensure that its stockpiled inventory is accurately and completely accounted for in its general ledger throughout the year;
  - b) Establish and implement a plan to perform a closed annual inventory count as required by FEMA Manual 6150.1 Section 4-4g, Section g., *Annual Inventory of Accountable Property*;
  - c) Provide more training and detailed instruction to Logistics Center staff on performing inventory counts, including the completion of count sheets and the performance of recounts; and
  - d) Reconcile the physical inventory counts, including the annual physical inventory, to the perpetual counts recorded in LIMS, and resolve related discrepancies.
2. TSA:
  - a) Formally modify its policy to define the placed in service date, which then begins the process of recording periodic depreciation expense;
  - b) Implement needed IT system changes to properly account for and maintain placed in service dates;
  - c) Work with its accounting services provider to discontinue the use of USSGL Account No. 1890 and record PP&E to the proper general ledger account upon purchase; and
  - d) Develop and implement management review controls over equipment purchase contracts to ensure that amounts advanced to vendors are properly accounted for given the terms of the underlying contract.
3. US-Visit implement procedures for developers to track and notify accounting personnel when software has been placed into production so that accounting personnel can properly classify and amortize the software costs, and appropriate and sufficient evidence is maintained to document management's decisions that lead to significant accounting transactions.

**II-F Other Liabilities (FEMA, G&T, and TSA)**

*Background:* In 2006, we reported that OFM and DHS General Counsel had not implemented adequate policies and procedures to accurately estimate and report an accrual for contingency legal liabilities. OFM, DHS General Counsel, and each of the DHS

|      | 2007 | 2006 | 2005 |
|------|------|------|------|
| OFM  | C    | NA   | N/A  |
| FEMA | MW   | NA   | NA   |
| G&T* | MW   | NA   | NA   |
| TSA  | SD   | SD   | NA   |

II. 15

\* G&T grants merged with FEMA in 2007

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component entities implemented a corrective action plan in 2007, and have successfully remediated the control deficiencies we reported last year.

For the first two fiscal quarters of FY 2007, the G&T was a component of the Preparedness Directorate within DHS. During this time, accounting services for G&T were provided by the Department of Justice through an interagency agreement. These accounting services included the development and implementation of a grant accrual methodology to be used in G&T's quarterly reporting financial reporting. Effective March 31, 2007, G&T's operations were transferred to FEMA as a result of the *Post-Katrina Emergency Management Reform Act of 2006*. The financial and grant data of G&T was fully transferred to FEMA on May 15, 2007. Accordingly, FEMA is now responsible for providing accounting services for G&T, including the grant accrual methodology, and prepares its monthly financial submissions used by OFM to prepare the DHS consolidated financial statements.

A part of TSA's employee compensation package includes annual leave, which accrues at varying rates and is based on years of service, and related benefits. The annual leave liability and related benefit accruals in TSA's financial statements at September 30, 2007, totaled approximately \$193 million.

*Conditions:* We noted the following internal control weaknesses related to other liabilities:

1. FEMA:

- Did not establish a reliable method, including validation of data and assumptions made, to estimate G&T grants payable [or advances] for accrual in the financial statements at September 30, 2007. FEMA management was unable to provide assurance that the accrued liability related to former G&T grants, was accurate, and complete at September 30, 2007.
- Did not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (see Exhibit IV-K, *Single Audit Act Amendments of 1996*).

2. TSA:

- Has not maintained all of the necessary supporting documentation for us to complete our audit procedures over accrued annual leave. From a sample of 75 items, 13 items could not be supported and 5 contained errors.
- Has not reconciled annual leave balances earned by employees per the payroll provider's output records to the data submitted by TSA and with the general ledger on a routine basis, which likely contributed to the errors identified in our sample.

*Cause/Effect:* FEMA did not have sufficient resources to perform all accounting functions related to the transfer of G&T grant administration and accounting that occurred in FY 2007. FEMA accounting staff used FEMA's historical methodology for estimating the grant liability for FEMA's grant portfolio to compute and record a grant liability at year end for the former G&T grant portfolio. However, FEMA was unable to validate this application of its methodology as appropriate and plans to perform its validation during FY 2008. Consequently, we were unable to complete our audit procedures over the accrued grant liability presented in the DHS consolidated balance sheet at September 30, 2007. Additionally, without effective procedures to timely resolve and close audit reports with identified questioned costs or other findings, the circumstances leading to the findings may continue to exist and amounts due to the government may not be received timely.



**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

The portion of TSA's annual leave liability that is in question relates to a balance that was transferred from a payroll system that has been replaced. Supporting information is not readily available to determine the correct liability at September 30, 2007.

*Criteria:* GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

SAS No. 57, *Auditing Accounting Estimates*, states "An entity's internal control may reduce the likelihood of material misstatements of accounting estimates. Specific relevant aspects of internal control include the following: Accumulation of relevant, sufficient, and reliable data on which to base an accounting estimate and comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates."

OMB Circular No. A-133 states that grants should be monitored by the grant making organization.

*Recommendations:* We recommend that:

1. FEMA:
  - a) Develop, test (e.g., validation of data and assumptions made), and implement a reliable method to periodically estimate G&T grants payable [or advances] for accrual in the financial statements during the year; and
  - b) Implement policies and procedures to ensure full compliance with OMB Circular No. A-133.
2. TSA:
  - a) Develop and perform procedures to enable management to assert to the appropriateness of the "beginning" accrued leave balance at a point in time (e.g., October 1, 2007). For example, these procedures may involve validating leave balances for all TSA employees at the selected point in time. These procedures should require that sufficient documentation be retained for purposes of the annual financial statement audit; and
  - b) Develop and implement policies and procedures to reconcile annual leave balances per its payroll provider output records to input records submitted by TSA and to the TSA general ledger each pay period. These reconciliations should be documented, reviewed by an appropriate supervisor, and maintained.

**II-G Budgetary Accounting (FEMA and TSA)**

*Background:* Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Combined, DHS has over 300 separate Treasury fund symbols (TAFS), each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multiyear, and no-

|          | 2007 | 2006 | 2005 |
|----------|------|------|------|
| FEMA     | MW   | SD   | SD   |
| TSA      | MW   | SD   | SD   |
| ICE      | C    | SD   | SD   |
| MGMT     | C    | SD   | N/A  |
| US-Visit | C    | SD   | N/A  |



**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

year appropriations; and several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to manage the funds of the Department and prevent overspending of allotted budgets.

Immigration and Customs Enforcement (ICE), Management Directorate, and U.S.-Visit each developed and implemented corrective action plans during FY 2007, to address the internal control weaknesses in budgetary accounting that we reported in our 2006 report.

The National Response Plan (NRP) calls for use of Other Federal Agencies (OFA) to provide goods and services to assist FEMA with its response to a disaster, as needed. The NRP defines a Mission Assignment as the vehicle used by FEMA to support Federal operations during a major disaster or emergency declaration covered under the *Stafford Act*. These work orders are issued by FEMA to OFAs to direct completion of a specific task and represent the primary documentation maintained by FEMA to support its obligations for disaster relief operations/programs being performed by OFAs.

TSA has substantial obligations and undelivered orders at year end, primarily for contract services and purchases of equipment. TSA's Office of Acquisition in coordination with TSA's Office of Financial Management monitors obligation activity and provides key input data needed to properly deobligate funds and prepare an accurate accounts payable estimate.

*Conditions:* We noted the following internal control weaknesses related to budgetary accounting:

1. FEMA:

- Did not adequately monitor the status of its obligations and ensure the timely deobligation of mission assignments resulting in a material misstatement of UDOs at the time of our testwork. We noted the following:
  - In a sample of 74 mission assignment obligations, approximately 50 percent were past their projected end dates by more than 120 days, and in some cases more than a year; and
  - Quarterly reviews of open obligations required by FEMA policies were not consistently performed or documented in the supporting records.
- OFA's did not always provide FEMA with timely progress reports that included sufficient cost/billing data. Sufficient documentary evidence was not obtained and/or documented timely for mission assignment manager follow-up procedures with the OFAs.

2. TSA:

- Does not have a funds control process in place to monitor outstanding obligation balances on a periodic basis (e.g., quarterly). During our interim testwork we identified 7 errors out of a sample of 75 items, and a projected overstatement undelivered orders of approximately \$200 million. During our year-end testwork we identified 26 errors out of a sample of 195 items, and a projected overstatement of undelivered orders of approximately \$130 million.
- Does not have sufficient policies and procedures requiring contract officers to monitor and close-out contracts, and we noted some deficiencies in the effectiveness of TSA's validation and verification process conducted over its obligations during the second half of FY 2007.

**Independent Auditors' Report****Exhibit II – Material Weaknesses – DHS Civilian Components**

- Completed an investigation over certain obligations recorded in previous years and determined that a violation of the *Anti-deficiency Act* occurred in previous years (see Exhibit IV-P, *Anti-deficiency Act*).

*Cause/Effect:* Although TSA has initiated a validation and verification process over its obligations, TSA was unable to complete the process before September 30, 2007.

FEMA's ability to monitor and manage mission assignments continues to be affected by resource limitations. In addition, FEMA is dependent on OFA's to provide timely information on the status of mission assignment obligations throughout the year. Lacking this information, FEMA is unable to effectively monitor and account for outstanding mission assignments, e.g., recording a proper account payable and deobligating excess funds.

*Criteria:* FEMA's SOP for *Processing Mission Assignment and Interagency Payments for Fund Code 06*, updated April 2007, establishes the process for mission assignment closeouts. If no activity has been recorded within the last 90 days, the Disaster Finance Branch initiates the closeout process with the Region or Headquarters.

The FEMA Form 90-129, *Mission Assignment Agreement*, states that the OFA is responsible for submitting a Mission Assignment Monthly Progress Report to FEMA to include cost data when mission assignments take more than 60 days to complete, including billing. To assist with this process, OMB issued its Memorandum – *Yearend Accounting Guidance for Disaster Relief Fund Transactions* dated September 17, 2007.

The *Anti-deficiency Act* is a series of statutes prohibiting agencies from obligating or expending funds in advance of appropriation or apportionment. OMB Circular No. A-11 has strict requirements for notification and reporting Anti-deficiency violations. GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely.

According to JFMIP's *Core Financial System Requirements*, an agency's core financial management system must ensure that an agency does not obligate or disburse funds in excess of those appropriated and/or authorized and specific system edits and user notifications related to funds control must be in place. The *Federal Acquisition Regulation* Section 1.6 addresses the authorities and responsibilities granted contracting officers. Treasury's USSGL guidance specifies the accounting entries related to budgetary transactions.

OMB Circular No. A-123 states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs." This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FMFIA. This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities for which it performs for others on a yearly basis. These controls shall be highlighted in management's assurance statement that is provided to its customers. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

FFMIA Section 803(a) requires that each Agency implement and maintain a system that complies substantially with Federal financial management system requirements as stipulated by OMB Circular No. A-127.

**Independent Auditors' Report**  
**Exhibit II – Material Weaknesses – DHS Civilian Components**

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*Recommendations:* We recommend that:

1. FEMA:
  - a) Require all regional offices to perform a complete UDO review, monitor timely completion of this review, and ensure that all identified mission assignment deobligations are processed in the general ledger promptly;
  - b) Ensure that personnel follow the established policy for quarterly obligation reviews prior to the end of each quarter to timely determine whether the remaining balance on a mission assignment is valid, or whether a deobligation of the remaining balance is necessary;
  - c) Enforce the requirement that all OFA's submit not only a progress report when the mission assignment takes more than 60 days to complete, but a progress report every additional 30 days that the project remains either programmatically or financially incomplete. The report should include an estimated completion date and, when applicable, Form 90-136 should be submitted for extension of the projected end-date whenever the estimate for programmatic completion is more than 30 days;
  - d) Consider involving OMB in a permanent solution, such as Agreed-upon Procedures engagements, to ensure that FEMA receives sufficient and timely information from OFA's to properly account for obligations related to outstanding mission assignments; and
  - e) Consider adding additional temporary or permanent accounting staff to improve the deobligation process (our recommendations in I-A, *Financial Management Oversight and Entity Level Controls*, will also help address these conditions).
2. TSA:
  - a) Require contracting officers to review and certify whether obligations are valid or require deobligation on a periodic basis (e.g., quarterly);
  - b) Refine or develop a new general ledger reporting tool that provides the contracting officers accurate information regarding outstanding obligated balances to include information related to the last activity date to assist in aging the balance;
  - c) Refine existing processes by which the Business Management Office periodically examines outstanding obligations and makes recommendations (e.g., deobligation) on outstanding balances; and
  - d) Develop formal policies and procedures to assist in expediting deobligations of funds associated with invalid obligations in advance of a formal contract close out.

**Independent Auditors' Report**  
**Exhibit III – Significant Deficiency – DHS Civilian Components**

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**III-H Custodial Revenue and Drawback**

*Background:* CBP collects approximately \$30 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries. Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements. CBP is the only DHS component with significant custodial responsibilities.

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Bonded Warehouses (BW) are facilities under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are considered outside of the CBP territory, upon activation. In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of origin.

*Conditions:* We noted the following internal control weaknesses related to custodial activities at CBP:

*Related to drawback:*

- The Automated Commercial System (ACS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls.
- Drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed.

*Related to the entry process – collection of taxes, duties and fees:*

- Policies, procedures, and general guidance provided to field offices related to review procedures, and documentation requirements for the monthly review of the entry process are weak. Consequently, we noted a number of instances of noncompliance with CBP guidelines, inconsistencies in review performance, and a lack of documentation to confirm performance of the monthly reviews.

*Related to BW, FTZ, and In-bond:*

- We noted inconsistencies in the performance of risk assessments and compliance reviews of BWs, and FTZs, and in-bond entries in various ports. In addition, HQ review of the BW and FTZs assessment results can take up to six months to compile and analyze. Further, no policies or procedures exist to monitor the results of the in-bond audits/reviews.
- CBP is unable to determine the status of the in-bond shipments with the information available within ACS.

*Cause/Effect:* CBP has been challenged to balance its commitment of limited resources to two important mission objectives – trade compliance, including the collection of taxes, duties and fees owed to the Federal government, and securing the U.S. borders from potential terrorist entry. In FY 2007, CBP made significant improvements in its custodial review controls and measurement

### **Independent Auditors' Report**

#### **Exhibit III – Significant Deficiency – DHS Civilian Components**

processes, procedures, and policies. For drawback, much of the process is manual until planned IT system functionality improvements are made, placing an added burden on limited resources.

*Criteria:* Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Revised Implementation Guidance for FFMIA*, states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations.

JFMIP publications and OMB Circular No. A-127 outlines the requirements for Federal systems. JFMIP's *Core Financial System Requirements* state that the core financial system must maintain detailed information by account sufficient to provide audit trails and to support billing and research activities. OMB Circular No. A-127 requires that the design of financial systems should eliminate unnecessary duplication of a transaction entry. Wherever appropriate, data needed by the systems to support financial functions should be entered only once, and other parts of the system should be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.

The *Improper Payments Information Act of 2002*, effective in FY 2004, requires agencies to assess the risk of erroneous payments and develop a plan to correct control weaknesses. In addition to the regulatory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

*Recommendations:* We recommend that CBP:

*Related to drawback:*

- a) Implement effective internal controls over drawback claims as part of any new systems initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims; and
- b) Implement automated controls within ACS to prevent overpayment of a drawback claim that is subject to deem liquidation.

*Related to entry:*

- a) Provide additional detail in the guidelines, specifying the sample size, procedures to perform, and documentation requirements for the CM Coordinator's review of the Import Specialists' review. The guidance should also readdress the timing requirements for the monitoring reports or data queries and documentation retention; and
- b) Conduct periodic training to ensure that all port personnel have comprehensive knowledge of the CM program requirements.

*Related to BW, FTZ, and In-bond:*

- a) Ensure adequate communication of the ports requirements related to the annual risk assessments and compliance reviews and provide effective training so that all responsible personnel are aware of and can consistently execute all of the requirements; and
- b) Implement a standard procedure to periodically compile the results of all In-bond audit/reviews during the year and develop an analysis function in order to evaluate the importers' compliance with regulations.



## Independent Auditors' Report

### Exhibit IV – Compliance and Other Matters

#### (Exhibits I and II include Comments A – G, and Exhibit III presents Comment H)

All of the compliance and other matters described below are repeat conditions except IV-P *Anti-deficiency Act*, which is new finding in FY 2007.

#### IV-I *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to 1) develop and implement management controls; 2) assess the adequacy of management controls; 3) identify needed improvements; 4) take corresponding corrective action; and 5) report annually on management controls. During FY 2007, DHS developed a CAP titled *Internal Controls over Financial Reporting Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 also facilitates compliance with FMFIA and the *DHS Financial Accountability Act of 2004*, which requires an annual audit of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA and OMB Circular No. A-123, the Coast Guard has not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls, and conformance of accounting systems. In addition, TSA and FEMA's control assessment processes require improvement to ensure full compliance with FMFIA.

**Recommendations:** We recommend that the Coast Guard, FEMA, and TSA fully implement the FMFIA process, as prescribed by the OCFO, to ensure full compliance with FMFIA and its OMB approved plan for Circular No. A-123 implementation in FY 2008. We also recommend that the OCFO consider additional training for its components, to ensure a thorough understanding of requirements.

#### IV-J *Federal Financial Management Improvement Act of 1996 (FFMIA)*

Passage of the *DHS Financial Accountability Act of 2004* made DHS subject to the FFMIA, beginning in FY 2005. FFMIA Section 803(a) requires that agency Federal financial management systems comply with 1) Federal accounting standards, 2) Federal system requirements, and 3) the USSGL at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability. Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to 1) develop and implement management controls; 2) assess the adequacy of management controls; 3) identify needed improvements; 4) take corresponding corrective action; and 5) report annually on management controls. During FY 2007, DHS OCFO continued with its implementation of OMB Circular No. A-123, by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes as planned. DHS' implementation of OMB Circular No. A-123 also facilitates compliance with the *DHS Financial Accountability Act of 2004*, which requires an annual audit of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA and OMB Circular No. A-123, the Coast Guard, FEMA, and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS also has stated in the Secretary's Assurance Statements dated November 15, 2007, as listed in Management's Discussion and Analysis (MD&A) of the Department's 2007 *Annual Financial Report* (AFR), that the Department cannot provide assurance that its financial

#### **Independent Auditors' Report**

##### **Exhibit IV – Compliance and Other Matters**

management systems are in substantial compliance with the requirements of FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for 1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; 2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and 3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Exhibits I-C and II-C *Financial Systems Security*, which impact the Department's ability to fully comply with FISMA.

*Recommendations:* We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III in FY 2008.

#### **IV-K Single Audit Act Amendments of 1996, and Laws and Regulations Supporting OMB Circular No. A-50, Audit Follow-up, as revised**

During 2007, DHS' G&T Directorate merged its grants making function with FEMA. FEMA is now the only DHS component that has a significant grant making operation. OMB Circular No. A-133 requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on grantee Single Audit findings. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2007. We noted that FEMA does not always obtain and review grantee Single Audit reports in a timely manner, and follow up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the GAO, and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. The DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the DHS Internal Controls over Financial Reporting (ICOFR) "Playbook." Progress is monitored by the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the OCFO directive to develop corrective actions, and they have been reviewed and approved by the CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in described in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2007.

## Independent Auditors' Report

### Exhibit IV – Compliance and Other Matters

*Recommendations:* We recommend that:

*Regarding Single Audit Act Amendments of 1996:*

1. FEMA develop procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2008:
  - a) Further develop and implement a tracking system to identify each grantee for which an OMB Circular No. A-133 Single Audit is required, and the date the audit report is due;
  - b) Strengthen communication with the cognizant agencies;
  - c) Use the tracking system to ensure audit and performance reports are received timely, or to follow-up when reports are overdue; and
  - d) Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

*Regarding OMB No. A-50, Audit Follow-up, as revised*

2. DHS continue to follow and complete the actions defined in its ICOFR "Playbook," to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2008.

#### IV-L *Improper Payments Information Act of 2002*

DHS is required to comply with the *Improper Payments Information Act of 2002* (the Act or IPIA). The Act requires agencies to review all programs and activities they administer annually and identify those that may be susceptible to significant erroneous payments. For all programs and activities where the risk of erroneous payments is significant, agencies must estimate the annual amounts of erroneous payments, and report the estimates to the President and Congress with a progress report on actions to reduce them. The agency must report a statistically valid error projection for susceptible programs in its annual Performance and Accountability Report (PAR). To facilitate the implementation of the Act, OMB issued guidance in Memorandum M-03-13, *Implementation Guide for the Improper Payments Information Act of 2002*, and in Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*, to OMB Circular No. A-123, *Management's Responsibility for Internal Controls*, which provides a recommended process to meet the disclosure requirements.

In FY 2007, we noted the Department has taken positive steps toward full compliance with IPIA, and Appendix C of OMB Circular No. A-123, including identification of programs subject to IPIA, conducting a comprehensive process to assess the risk of programs susceptible to improper payments, and performing sample testing of programs. However, DHS did not fully comply with the Act in FY 2007. We noted that at DHS and its components:

- Some federal disbursements were excluded from the scope of DHS IPIA testwork performed.
- Some programs identified as high risk of significant improper payments during the assessment process were not tested, and some programs identified as low risk of significant improper payments were selected for testing. Accordingly, this sample testing did not meet the IPIA requirements in FY2007.
- The testing time frames selected for some components were not approved by OMB in advance, and in some cases the testing timeline did not appear to provide enough time to complete testwork over selected programs.

## Independent Auditors' Report

### Exhibit IV – Compliance and Other Matters

- CAPs were not developed for all programs identified as “high risk” during the risk assessment process, if no statistical sampling was performed to validate those risks during FY2007 due to DHS’ multi-year compliance plan.

*Recommendation:* We recommend that DHS risk assessments be completed earlier in the year so that programs identified as high risk by risk assessments are the programs that are sample tested. DHS needs to strengthen oversight of components’ progress in implementing corrective action plans and in recovering improper payments for high-risk programs. Also, DHS should review sample testing procedures and begin to independently validate the results of components’ sample testing.

#### IV-M Chief Financial Officers Act of 1990

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS’ OIG has engaged an independent auditor to audit the September 30, 2007 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

*Recommendation:* We recommend that DHS, and its components continue to implement the corrective action plans described in DHS’ ICOFR “Playbook” (see Comment IV – I, *Federal Managers’ Financial Integrity Act of 1982*, above) to remediate the FY 2007 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

#### IV-N Government Performance and Results Act of 1993 (GPRA)

The *Government Performance and Results Act* requires each agency to develop a strategic plan, that includes a description of how goals and objectives are to be achieved, including a description of the operational processes, skills and technology, and the human, capital, and other resources required to meet those goals and objectives. The Department’s annual performance plan and performance reports, that measure progress toward achieving strategic goals and related performance metrics are also integral to compliance with GPRA. We noted that DHS’ Strategic Plan expired on October 1, 2006 and the Department has not yet provided an updated Strategic Plan as of September 30, 2007. Consequently, the Department is not in compliance with the requirements of GPRA during FY 2007. In addition, we noted that the existing (expired) strategic plan did not align all strategic objectives to performance objectives as required.

*Recommendation:* We recommend that DHS ensure full compliance with GPRA by completing its updated Strategic Plan and aligning all performance goals to its strategic objectives in FY 2008.

#### IV-O Debt Collection Improvement Act of 1996 (DCIA)

The *DCIA of 1996* (DCIA) is intended to significantly enhance the Federal Government’s ability to service and collect debts. Under the DCIA, the Treasury assumes a significant role for improving government-wide receivables management. The DCIA requires Federal agencies to refer eligible delinquent nontax debts over 180 days to U.S. Treasury for the purpose of collection by cross-servicing or the offset program. Our tests of compliance disclosed instances where DHS was not in compliance with certain provisions of the DCIA. Specifically, we noted that due process is not performed in a timely manner to ensure that some eligible debts are forwarded to

**Independent Auditors' Report**  
**Exhibit IV – Compliance and Other Matters**

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the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.

*Recommendation:* We recommend that DHS develop policies and procedures to ensure full compliance with the DCIA in FY 2008.

**IV-P Anti-deficiency Act**

DHS and TSA management notified us of an *Anti-deficiency Act* violation that occurred in the TSA, Expenses Account, Treasury Symbol – 70X0508 in an amount up to \$155 million, where expenditures and obligations exceeded available funding in FY 2004. The DHS Secretary has reported the violation to the President of the United States, the President of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351. After establishing certain budgetary authority within its DHS general ledger through a journal entry, the related individual purchase orders were then recorded and the journal entry reversed in March 2003. A subsequent transaction in May 2003 erroneously reversed the initial journal entry amount again. This second journal entry reversal, which led to the *Anti-deficiency Act* violation, overstated TSA's budget authority by underreporting its existing obligations. A separate notification of the final determination is still required under 31 U.S.C. section 1351.

*Recommendation:* We recommend that TSA continue to implement the remedial actions resulting from its internal investigation of this matter.



**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

| <b>Summary of Conditions<br/>As Reported in 2006 DHS Performance and Accountability Report</b>                                  |   | <b>Fiscal Year 2007<br/>Status/Disposition</b> |
|---|---|--|
| <b>Material Weaknesses:</b>   |   |  |
| <b>A. Financial Management and Oversight</b>  |   |  |
| <b>A.1</b>  | The Coast Guard had not fully implemented a financial management organizational structure that supports the development and implementation of effective policies, procedures, and internal controls to ensure data supporting financial statement assertions are complete and accurate. The Coast Guard had not established clear management oversight responsibilities and processes to review adjustments to account balances, identify the cause of abnormal balances, and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, and investigate potential financial system concerns such as potential posting logic errors. The Coast Guard had not fully established management oversight functions to ensure that accounting principles are correctly applied, and to provide accounting operational guidance to other offices and facilities within the Coast Guard. The Coast Guard has not completed a comprehensive Corrective Action Plan to correct longstanding internal control weaknesses. | <b>Repeated</b><br>(Exhibit I-A)               |
| <b>A.2</b>  | The OFM did not have a sufficient number of management personnel with the requisite financial accounting background to both (i) set-up, and (ii) effectively manage the financial reporting and internal controls infrastructure of a large Executive Branch agency. The OFM had not provided effective management and oversight throughout the year to monitor the operations of DHS components to promptly identify and raise issues to the CFO that may affect the quality of the financial statements. OFM had not established a process to support the timely completion of the annual financial statement audit.  | <b>Corrected</b>                               |
| <b>B. Financial Reporting (This finding has been combined with finding J below and reported as Financial Reporting in 2007)</b> |   |  |
| <b>B.1</b>  | The OFM continued to have significant difficulty coordinating delivery of financial data from components and preparing financial statements and disclosures throughout the year. The OFM had not established Departmental policies and procedures, or issued timely guidance to ensure that financial statements are accurate and complete during the year. Fully documented policies and procedures for many critical activities necessary to adequately manage financial reporting processes, and monitoring controls to ensure monthly TIER submissions received from the components were prepared timely and accurately.  | <b>Partially Repeated</b><br>(Exhibit II-B)    |

V.1

**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

| <b>Summary of Conditions<br/>As Reported in 2006 DHS Performance and Accountability Report</b> |   | <b>Fiscal Year 2007<br/>Status/Disposition</b>       |
|--|---|--|
| <b>B.2</b>   | The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the USSGL, and TIER submissions to OFM were from a database that did not have detail back-up support for some on-top adjustments at the transaction level. The Coast Guard's financial reporting process was complex and labor-intensive, and required a significant number of "on-top" adjustments (adjustments made outside the core accounting system for presentation of financial information given to DHS for consolidation). The Coast Guard had serious deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not record all financial transactions to the general ledger systems or have adequate beginning balance and year-end close out procedures. The Coast Guard routinely used analytical comparisons to identify adjusting entries to the financial statements, without verifying that the ending balances were properly supported at the transaction level, e.g., budgetary accounts were adjusted to equal proprietary accounts, without verifying that the underlying transactional detail supported the ending balances. The Coast Guard did not have adequate procedures and internal controls over the process of preparing and reviewing the financial statement disclosures and did not have an adequate process to record, review, and monitor accounts receivable activity. | <b>Repeated</b><br>(Exhibit I-B)                     |
| <b>B.3</b>   | TSA continued to experience difficulties related to financial reporting. Specifically, we noted that certain accrual amounts were not posted and certain property amounts were misstated in the final financial data submission for the June 30, 2006 hard-close; numerous other on-top adjustments were made thereafter, account reconciliations were not performed timely or completely throughout the year, and material abnormal balances and analytical account variances were not resolved timely throughout the year. TSA did not have sufficient processes and procedures established to enable the successful completion of a financial statement audit. TSA could not provide complete supporting documentation for numerous journal vouchers.  | <b>Corrected</b>                                     |
| <b>B.4</b>   | OFM and certain components did not have effective financial information systems, or sufficiently documented processes, to accumulate cost data by DHS strategic goal, as required by SFFAS No. 4, <i>Managerial Cost Accounting Concepts and Standards</i> .  | <b>Partially Repeated</b><br>(Exhibit II-B)          |
| <b>C. Financial Systems Functionality</b>  | OCFO and DHS bureaus have IT and financial system security control weaknesses in entity-wide security program planning and management, access controls, application software development and change controls, system software, segregation of duties, and service continuity.   | <b>Partially Repeated</b><br>(Exhibits I-C and II-C) |

V.2

**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

**Summary of Conditions  
As Reported in 2006 DHS Performance and Accountability Report**

**Fiscal Year 2007  
Status/Disposition**

**D. Fund Balance with Treasury (FBwT)**

The Coast Guard did not effectively manage its suspense accounts to include accurately aging and clearing items carried in suspense clearing accounts in a timely manner during the year, and did not maintain adequate supporting documentation that validated the accuracy of the FBwT reconciliations and the clearing of suspense items.

**Repeated  
(Exhibit I-D)**

**E. Property, Plant, and Equipment** *(This finding has been combined with finding F below and reported as Capital Assets and Supplies in 2007)*

**E.1**

The Coast Guard had not implemented appropriate controls and related processes to accurately, consistently, and timely record PP&E, to include additions, transfers from other agencies and disposals in its fixed asset system. The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation supporting PP&E acquisitions is maintained, and readily available for audit. The Coast Guard lacked methodologies and assumptions to support the value of PP&E that is not supported by original acquisition or other documentation. The Coast Guard needed an asset identification, system mapping, and tagging processes that included sufficient detail, e.g., serial number, to clearly differentiate and accurately track assets in the fixed asset system. The Coast Guard lacked an effective physical inventory process and appropriate support for the valuation method and classification of repairable PP&E to ensure accounting and reporting for PP&E is consistent with generally accepted accounting principles.

**Repeated  
(Exhibit I-E)**

**E.2**

US-Visit did not consistently apply procedures to identify and capitalize software development costs or to reclassify software placed into production from software in development. Consequently US Visit was unable to fully support the accuracy and completeness of certain property, plant, and equipment balances, to allow us to complete our testwork, prior to the completion of DHS' 2006 PAR.

**Partially  
Repeated  
(Exhibit II-E)**

**E.3**

TSA did not implement adequate policies and procedures to properly account for and support property balances. Subsidiary records has not been reconciled to the general ledger timely, a sub component of the general ledger had not been updated for depreciation, additions, and disposals related to certain property and equipment, and TSA was unable to provide adequate supporting documentation to support valuation of its property.

**Corrected**

V.3

**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

**Summary of Conditions**  
**As Reported in 2006 DHS Performance and Accountability Report**  
**Fiscal Year 2007**  
**Status/Disposition**

| <b>F. Operating Materials and Supplies</b><br><i>(This finding has been combined with finding E above and reported as Capital Assets and Supplies in 2007)</i>   |  |                                   |
|--|--|-----------------------------------|
| <b>F.1</b> At the Coast Guard, internal controls over physical counts at field locations were not designed and implemented to remediate conditions identified during fiscal year 2003 and 2004. OM&S items were not always properly bar-coded or tagged, on-hand quantities frequently did not agree to the perpetual inventory records, and procedures did not sufficiently address whether all inventory on hand was properly recorded in the perpetual records or require discrepancies to be resolved timely. Processes and controls were not in place to fully support the calculated value of field-held and ICP OM&S to approximate historical cost. Policies, procedures and controls designed to remediate conditions related to conducting physical inventories of OM&S at the ICPs were not completely implemented.   |  | <b>Repeated</b><br>(Exhibit I-E)  |
| <b>G. Legal and Other Liabilities</b><br><i>(This finding has been combined with finding H below and reported as Actuarial and Other Liabilities in 2007)</i>  |  | <b>Corrected</b>                  |
| <b>G.1</b> OFM, in association with OGC, had not implemented adequate policies and procedures to ensure that OFM is provided with sufficient information to accurately and completely present legal liabilities and related disclosures in the financial statements throughout the year.   |  |                                   |
| <b>G.2</b> The Coast Guard did not use a reliable methodology to estimate accounts payable. The method used was not supported as to the validity of data, assumptions, and criteria used to develop and subsequently validate the reliability of the estimate for financial reporting. Did not have adequate policies, procedures and internal controls over Coast Guard's process for reconciling military payroll recorded in the CAS general ledger to detail payroll records. Military personnel data changes, including changes in leave balances and payroll corrections, are not processed to be reflected in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. Did not have documented policies and procedures, including appropriately designed internal controls, to ensure that the Coast Guard legal liabilities, included with the Department's accrued and disclosed contingent liabilities in the balance sheet at September 30, 2006, are accurate and complete. In addition, information is not prepared on a quarterly basis as necessary to prepare accurate timely financial statements throughout the year. |  | <b>Repeated</b><br>(Exhibit I-F)  |
| <b>G.3</b> G&T did not establish a reliable method, including validity of data and assumptions made, to estimate its grants payable [or advances] for accrual in the financial statements until the end of the fourth quarter of fiscal year 2006. (G&T grants merged with FEMA during 2007)   |  | <b>Repeated</b><br>(Exhibit II-F) |

V.4

**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

**Summary of Conditions  
As Reported in 2006 DHS Performance and Accountability Report**

|            |  | <b>Fiscal Year 2007<br/>Status/Disposition</b> |
|------------|--|--|
| <b>G.4</b> | TSA did not implement a new grant accrual methodology until August 2006, and the new methodology did not consider non-reporters. Therefore, the underlying expenditure data used in the accrual percentage and the actual expenditure data subsequently used for comparison/validation purposes may not be complete (corrected). Was unable to reconcile its annual leave subsidiary ledger to the general ledger during the year, creating an out-of-balance condition in July (repeated).  | <b>Partially Repeated</b><br>(Exhibit II-F)    |
| <b>G.5</b> | FEMA did not estimate and accrue accounts payable for all material open mission assignments at year-end. FEMA only accrued for mission assignments for which a payable confirmation had been received from the other Federal agency. Did not have fully effective policies and procedures to ensure that insurance company financial data collected through a third-party service provider was accurate and complete, affecting the reliability of its accounts payable balance as of September 30, 2006.  | <b>Partially Repeated</b><br>(Exhibit II-F)    |
| <b>G.6</b> | FEMA and TSA did not have sufficient policies and procedures in place to fully comply with the OMB Circular No. A-133, <i>Audits of States, Local Governments, and Non-profit Organizations</i> , and laws and regulations supporting OMB Circular No. A-50, <i>Audit Follow-up</i> , as revised.  | <b>Partially Repeated</b><br>(Exhibit II-F)    |
| <b>H.</b>  | <b>Actuarial Liabilities</b> ( <i>This finding has been combined with finding G above and reported as Actuarial and Other Liabilities in 2007</i> )  | <b>Repeated</b><br>(Exhibit I-F)               |
| <b>H.1</b> | The Coast Guard was unable to fully support its assertions relating to accuracy and completeness of the underlying participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS, and post employment travel benefits liabilities. The Coast Guard did not follow established policies and procedures to accumulate data for the actuary to compute post-employment travel benefits. The Coast Guard did not perform periodic reconciliations between the medical expenditures subsidiary ledger and the general ledger. The Coast Guard did not have effective policies, procedures, and controls to monitor the expenditures for medical services to ensure they were billed at proper rates and for valid participants only, e.g., service members and their families, and retiree/survivors. |  |

V.5



**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

**Fiscal Year 2007  
Status/ Disposition**

**Summary of Conditions  
As Reported in 2006 DHS Performance and Accountability Report**

| <b>I. Budgetary Accounting</b> |   |   |
|--------------------------------|---|---|
| <b>I.1</b>                     | Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, obligations incurred were recorded timely, and that proper approvals and supporting documentation is maintained. Coast Guard has not designed or implemented a comprehensive internal control program across all components of the organization to prevent or detect and correct misstatements to UDO balances reported on the financial statements. In addition, programming logic and transaction codes used to record advances for which an obligation was not previously recorded are not operating effectively to ensure the obligation and UDO are properly recorded. Procedures and controls are not adequate to prevent a commitment or obligation of funds in excess of established appropriations. Obligations were recorded in FPD, but were not properly interfaced with the CAS, and were not supported by adequate documentation. Obligations related to post-employment permanent changes of station (PCS) were not recorded at the time orders were approved and issued. Automated system controls are not effectively used to prevent the processing of procurement transactions by contracting officer's with expired warrant authority, and a manual compensating control was not effective since listings of warranted contracting officers were not complete. | <b>Repeated</b><br>(Exhibit I-G)            |
| <b>I.2</b>                     | TSA did not maintain, documentation supporting UDOs and related purchase information in a manner that is readily available to management and the auditors. Consequently, TSA was unable to provide sufficient documentation to support a sample of UDO balances at year-end prior to the completion of the DHS' 2006 PAR. Has developed, but not fully implemented, IT system programming logic which allows the accounting system to record obligations recovered at the transaction level in accordance with SGL requirements.  | <b>Partially Repeated</b><br>(Exhibit II-G) |
| <b>I.3</b>                     | FEMA did not have adequate resources to monitor the status and ensure the timely deobligation of mission assignments, resulting in an overstatement of UDOs at the time of our testwork. Did not maintain adequate communications with its grants disbursements service provider regarding the reliability of its internal controls. In fiscal year 2006, FEMA's grant disbursement service provider received a qualified opinion over the effectiveness of its internal controls for the period October 1, 2005, to June 30, 2006. However, FEMA was not aware of these control deficiencies until late October 2006, and consequently, payment information from the third-party service provider used to reduce obligations in its general ledger may not be accurate   | <b>Partially Repeated</b><br>(Exhibit II-G) |
| <b>I.4</b>                     | ICE has not completed its validation and verification of FPS prior year obligations, in order to determine the propriety of the completeness, existence, and accuracy of those obligations.   | <b>Corrected</b>                            |

V.6

**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

| <b>Summary of Conditions<br/>As Reported in 2006 DHS Performance and Accountability Report</b> |  | <b>Fiscal Year 2007<br/>Status/Disposition</b> |
|--|--|--|
| <b>I.5</b>   | Management Directorate had not established policies and procedures to ensure that obligations are recorded timely. Had not established policies and procedures to ensure that all key attributes of an obligation and purchase are recorded in the financial accounting system.  | <b>Corrected</b>                               |
| <b>I.6</b>   | US-Visit has not established policies and procedures to ensure that documentation supporting obligations and subsequent disbursements is filed and readily available for management and auditor review.  | <b>Corrected</b>                               |
| <b>J.</b>  | <b>Intragovernmental and Intradepartmental Balances</b> <i>(This finding has been combined with finding B above and reported as Financial Reporting in 2007)</i><br>OFM has not been able to reconcile intragovernmental asset, liability, and revenue amounts with trading partners, as required by OMB Circular No. A-136. OFM did not coordinate a DHS-wide reconciliation throughout the year of all intragovernmental balances. We noted that DHS, in cooperation with its components, have not developed and adopted effective policies and procedures, or established systems, to completely track, confirm, and reconcile intra-governmental balances and/or transactions with trading partners in a timely manner, which contributed to the material differences, cited below in 2006. The <i>Material Differences Reports</i> submitted to Treasury identified accounting/reporting errors of approximately \$1.4 billion in both the first and second quarter 2006. These differences were primarily related to activity with the following trading partners: 96-U.S. Army Corps of Engineers and 97-Office of the Secretary of Defense-Defense Agencies. These differences were not fully reconciled/ resolved by the following quarter. | <b>Repeated</b><br>(Exhibit II-B)              |
| <b>Other Reportable Conditions:</b>  |  |  |
| <b>K.</b>  | <b>Environmental Liabilities</b>   |  |
| <b>K.1</b>   | At the Coast Guard consistent policies or procedures have not been developed for the identification, evaluation, and estimation of potential environmental remediation of Coast Guard sites, thereby resulting in different approaches by shore facility commands and ultimately varying liability estimates.  | <b>Repeated</b><br>(Exhibit I-F)               |

V.7

**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

**Summary of Conditions**  
**As Reported in 2006 DHS Performance and Accountability Report**

**Fiscal Year 2007**  
**Status/Disposition**

**Corrected**

**K.2** FLETC had not implemented effective policies and procedures to accurately and completely estimate its liabilities. Consequently, FLETC's liability for lead contamination at its SAFRs was substantially understated and required an adjustment to the financial statements at year-end. Implemented a process to completely identify the existence of lead-paint and asbestos contamination, and to accurately estimate the cost of clean-up for financial statement purposes. The estimation process used in fiscal year 2006 was not supported by a detailed analysis that, among other things, considered the actual square footage of the contaminated area and the type of asbestos contamination.

**L. Custodial Revenue and Drawback**

At CBP related to drawback the ACS lacked automated controls to detect and prevent excessive drawback claims and over-payments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. ACS did not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries or export documentation upon which the drawback claim was based. ACS lacked controls to prevent overpayment of drawback claims at the summary line level that were subject to the new deem liquidation process put in place during fiscal year 2006. CBP drawback review policy and procedures allowed drawback specialists, with supervisory approval, to judgmentally decrease the number of ACS selected underlying consumption entries randomly selected for review, thus decreasing the review's effectiveness.

**Repeated**  
**(Exhibit III-H)**

Related to the entry process – collection of taxes, duties and fees – policies, procedures, and general guidance provided to CMP coordinators related to sampling, review procedures, and documentation requirements for the monthly review of CM results are weak. The National Analysis Specialist Division port audits were no longer performed during FY 2006. CBP lacks formal policies and procedures to ensure the CM data used for analysis and to compute the revenue gap is accurately and completely input into the IT system.

Related to BW, FTZ, and In-bond we noted inconsistencies in the performance of risk assessments and compliance reviews of BWs, and FTZs, and in-bond entries in various ports.

V.8

**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

| <b>Summary of Conditions<br/>As Reported in 2006 DHS Performance and Accountability Report</b>  |   | <b>Fiscal Year 2007<br/>Status/Disposition</b> |
|---|---|--|
| <b>Compliance and Other Matters:</b>  |   |  |
| <b>M. Federal Managers' Financial Integrity Act of 1982</b>   | DHS management's FMFIA report did not contain corrective action plans for all material weaknesses identified in the PAR. In addition, DHS and its components have not established effective systems, processes, policies and procedures to evaluate and report on FMFIA compliance.   | <b>Repeated</b><br>(Exhibit IV-I)              |
| <b>N. Federal Financial Management Improvement Act of 1996</b>  | We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA.   | <b>Partially Repeated</b><br>(Exhibit IV-J)    |
| <b>O. Federal Information Security Management Act (Electronic Government Act of 2002)</b>   | We noted instances of non-compliance with FISMA that have been reported by us in the material weakness on <i>Financial Systems Security</i> .   | <b>Combined with FFMIA</b><br>(Exhibit IV-J)   |
| <b>P. Single Audit Act Amendments of 1996, and Laws and Regulations Supporting OMB Circular No. A-50, Audit Follow-up, as revised</b> | DHS did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports. DHS and its components did not fully develop and implement corrective action plans to address all material weaknesses and reportable conditions identified by previous financial statement audits within the time-frames established in OMB Circular No. A-50. We also noted that some corrective action plans lack sufficient detail, such as clearly defined roles and responsibilities, actions to be taken, time-table for completion of actions, and documented supervisory review and approval of completed actions. | <b>Partially Repeated</b><br>(Exhibit IV-K)    |
| <b>Q. Improper Payments Information Act of 2002</b>   | DHS did not properly define programs and activities, institute a systematic method of reviewing all programs and identifying those at risk of significant erroneous payments, and properly sample or compute the estimated dollar amount of improper payments.  | <b>Repeated</b><br>(Exhibit IV-L)              |

V.9

**Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings**

| <b>Summary of Conditions<br/>As Reported in 2006 DHS Performance and Accountability Report</b> |  | <b>Fiscal Year 2007<br/>Status/Disposition</b> |
|--|--|--|
| <b>R. DHS Financial Accountability Act of 2004 (Chief Financial Officers Act of 1990)</b>      | Section 3 of Public Law 108-330, <i>DHS Financial Accountability Act of 2004</i> , states that the President of the United States shall appoint a Chief Financial Officer of DHS not later than 180 days after the date of the enactment of this Act signed in October 2004, to be confirmed by the U.S. Senate. At September 30, 2005 DHS was operating with an Acting CFO, while no waiver or amendment to this law has been obtained by DHS management. The <i>DHS Financial Accountability Act of 2004</i> also made DHS subject to the <i>Chief Financial Officers Act of 1990</i> , as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2006, consolidated balance sheet and statement of custodial activity only. | <b>Repeated</b><br>(Exhibit IV-M)              |
| <b>S. Government Performance and Results Act of 1993</b>                                       | The validation and verification section of the fiscal year 2006 <i>DHS Annual Performance Plan</i> was incomplete and included erroneous data. In addition, no performance goals or measures were established or aligned to two of the Department's strategic objectives in the <i>Annual Performance Plan</i> . GPRA states that an agency may not omit or minimize the significance of any program activity constituting a major function or operation for the agency.   | <b>Repeated</b><br>(Exhibit IV-N)              |
| <b>T. The Debt Collection Improvement Act of 1996</b>  | DHS was not in compliance with certain provisions of the DCIA. Specifically, we noted that due process is not performed in a timely manner to ensure that some eligible debts are forwarded to Treasury for cross-servicing or the offset program within the timeframes established by DCIA.   | <b>Repeated</b><br>(Exhibit IV-O)              |

V.10




U.S. Department of Homeland  
Security  
Washington, DC 20528



**Homeland  
Security**

November 15, 2007

**MEMORANDUM FOR:** Richard L. Skinner, Inspector General  
**FROM:** David L. Norquist, Chief Financial Officer   
**SUBJECT:** FY 2007 Financial Statement Audit

This memo is our response to the Independent Public Accountant's audit of our balance sheets as of September 30, 2007 and 2006, and the related statement of custodial activities for the years then ended. We agree with the Independent Public Accountant's conclusions.

I would like to thank you for your efforts and the dedication shown by your staff and the Independent Public Accountant in working with the Department to improve financial management. Although the auditor's report on internal controls and compliance indicates that DHS still faces serious financial management challenges, I am encouraged to note that significant progress was made this year. This progress has been made possible through the tireless effort of many throughout the Department to implement meaningful corrective actions and develop strong processes and internal controls.

We are currently updating our plans to address the challenges identified by the auditors, as well as those noted by management during our A-123 assessment. Our plans will focus on sustaining progress at the components that have corrected weaknesses, as well as supporting corrective action plans in areas where weaknesses remain. Two particular challenges for the upcoming year will be the U.S. Coast Guard and the Federal Emergency Management Agency.

Financial management at DHS has come a long way. I am inspired by the extraordinary efforts of the Department's dedicated staff, and am most appreciative of the partnership we have forged with your office. Together we will continue to improve financial management and grow a cadre of leaders ready to address the mission challenges of the next decade.

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## Financial Statements

### Department of Homeland Security Balance Sheets As of September 30, 2007 and 2006 (In Millions)

|  | <u>2007</u><br>(Unaudited) | <u>2006</u><br>(Unaudited)<br>(Restated) |
|--|----------------------------|--|
| <b>ASSETS</b>  |                            |  |
| <b>Intragovernmental</b>                                     |                            |  |
| Fund Balance with Treasury (Notes 2 and 3)                   | \$56,185                   | \$59,569                                 |
| Investments, Net (Note 5)                                    | 2,778                      | 634                                      |
| Accounts Receivable, Net (Note 6)                            | 278                        | 247                                      |
| Other (Note 13)  |                            |  |
| Advances and Prepayments                                     | 2,887                      | 2,913                                    |
| Other (Note 2)   | 176                        | 411                                      |
| <b>Total Intragovernmental</b>                               | <b>\$62,304</b>            | <b>\$63,774</b>                          |
| Cash and Other Monetary Assets (Notes 2 and 4)               | 321                        | 99                                       |
| Accounts Receivable, Net (Notes 2 and 6)                     | 760                        | 1,181                                    |
| Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)    | 1,937                      | 1,755                                    |
| Direct Loans, Net (Note 8)                                   | -                          | 161                                      |
| Inventory and Related Property, Net (Note 9)                 | 632                        | 677                                      |
| General Property, Plant, and Equipment, Net (Notes 2 and 11) | 12,275                     | 11,151                                   |
| Other (Note 13)  |                            |  |
| Advances and Prepayments                                     | 567                        | 551                                      |
| <b>TOTAL ASSETS</b>  | <b>\$78,796</b>            | <b>\$79,349</b>                          |
| Stewardship Property, Plant, and Equipment (Note 12)         |                            |  |
| <b>LIABILITIES</b>   |                            |  |
| <b>Intragovernmental</b>                                     |                            |  |
| Accounts Payable   | \$2,066                    | \$1,907                                  |
| Debt (Note 15)   | 18,153                     | 17,446                                   |
| Other (Note 18)  |                            |  |
| Due to the General Fund                                      | 2,085                      | 1,809                                    |
| Accrued FECA Liability                                       | 355                        | 339                                      |
| Other  | 245                        | 187                                      |
| <b>Total Intragovernmental</b>                               | <b>\$22,904</b>            | <b>\$21,688</b>                          |
| Accounts Payable   | 3,003                      | 2,629                                    |
| Federal Employee and Veterans' Benefits (Note 16)            | 34,910                     | 32,278                                   |
| Environmental and Disposal Liabilities (Note 17)             | 275                        | 245                                      |
| Other (Notes 18, 19, 20, and 21)                             |                            |  |
| Accrued Payroll and Benefits                                 | 1,553                      | 1,362                                    |
| Deferred Revenue and Advances from Others                    | 2,727                      | 2,188                                    |
| Unliquidated Antidumping and Countervailing Duties           | 514                        | 34                                       |
| Insurance Liabilities  | 1,508                      | 3,567                                    |

| <b>Department of Homeland Security</b><br><b>Balance Sheets</b><br><b>As of September 30, 2007 and 2006</b><br><b>(In Millions)</b> |   |   |
|---|---|---|
|   | <u><b>2007</b></u><br><u><b>(Unaudited)</b></u> | <u><b>2006</b></u><br><u><b>(Unaudited)</b></u><br><u><b>(Restated)</b></u> |
| Refunds and Drawbacks   | 131   | 5,593   |
| Other   | 1,408   | 1,205   |
| <b>Total Liabilities</b>  | <u><b>\$68,933</b></u>                          | <u><b>\$70,789</b></u>  |
| Commitments and contingencies (Notes 19, 20, and 21)  |   |   |
| <b>NET POSITION</b>   |   |   |
| Unexpended Appropriations   |   |   |
| Unexpended Appropriations-Other Funds   | \$49,003  | \$48,816  |
| Cumulative Results of Operations  |   |   |
| Cumulative Results of Operations-Earmarked Funds (Note 22)  | (16,236)  | (19,337)  |
| Cumulative Results of Operations-Other Funds  | (22,904)  | (20,919)  |
| <b>Total Net Position</b>   | <u><b>\$9,863</b></u>                           | <u><b>\$8,560</b></u>   |
| <b>TOTAL LIABILITIES AND NET POSITION</b>   | <u><b>\$78,796</b></u>                          | <u><b>\$79,349</b></u>  |

The accompanying notes are an integral part of these statements.



**Department of Homeland Security**  
**Statements of Net Cost**  
**For the Years Ended September 30, 2007 and 2006**  
**(In Millions)**

| <b>Directorates and Other Components (Note 23 and 24)</b>  | <b><u>2007</u></b><br><b>(Unaudited)</b> | <b><u>2006</u></b><br><b>(Unaudited)</b><br><b>(Restated)</b> |
|--|--|---|
| <b><i>U.S. Customs and Border Protection</i></b>           |  |   |
| Gross Cost   | \$8,198                                  | \$7,135   |
| Less Earned Revenue  | <u>(157)</u>                             | <u>(153)</u>  |
| <b>Net Cost</b>  | <b><u>8,041</u></b>                      | <b><u>6,982</u></b>   |
| <b><i>U.S. Coast Guard</i></b>                             |  |   |
| Gross Cost   | 10,564                                   | 10,011  |
| Less Earned Revenue  | <u>(492)</u>                             | <u>(424)</u>  |
| <b>Net Cost</b>  | <b><u>10,072</u></b>                     | <b><u>9,587</u></b>   |
| <b><i>U.S. Citizenship and Immigration Services</i></b>    |  |   |
| Gross Cost   | 1,731                                    | 1,588   |
| Less Earned Revenue  | <u>(1,659)</u>                           | <u>(1,729)</u>  |
| <b>Net Cost</b>  | <b><u>72</u></b>                         | <b><u>(141)</u></b>   |
| <b><i>Federal Emergency Management Agency</i></b>          |  |   |
| Gross Cost   | 14,272                                   | 28,845  |
| Less Earned Revenue  | <u>(2,842)</u>                           | <u>(2,469)</u>  |
| <b>Net Cost</b>  | <b><u>11,430</u></b>                     | <b><u>26,376</u></b>  |
| <b><i>Federal Law Enforcement Training Center</i></b>      |  |   |
| Gross Cost   | 402                                      | 312   |
| Less Earned Revenue  | <u>(40)</u>                              | <u>(33)</u>   |
| <b>Net Cost</b>  | <b><u>362</u></b>                        | <b><u>279</u></b>   |
| <b><i>National Protection and Programs Directorate</i></b> |  |   |
| Gross Cost   | 855                                      | 743   |
| Less Earned Revenue  | <u>-</u>                                 | <u>(1)</u>  |
| <b>Net Cost</b>  | <b><u>855</u></b>                        | <b><u>742</u></b>   |
| <b><i>U.S. Immigration and Customs Enforcement</i></b>     |  |   |
| Gross Cost   | 4,891                                    | 4,500   |
| Less Earned Revenue  | <u>(900)</u>                             | <u>(857)</u>  |
| <b>Net Cost</b>  | <b><u>3,991</u></b>                      | <b><u>3,643</u></b>   |

**Department of Homeland Security**  
**Statements of Net Cost**  
**For the Years Ended September 30, 2007 and 2006**  
**(In Millions)**

|   | <u><b>2007</b></u><br><b>(Unaudited)</b> | <u><b>2006</b></u><br><b>(Unaudited)</b><br><b>(Restated)</b> |
|---|--|---|
| <b>Directorates and Other Components (Note 23 and 24)</b> |  |   |
| <i><b>Office of Health Affairs</b></i>                    |  |   |
| Gross Cost  | 5  | 53  |
| Less Earned Revenue                                       | -  | -   |
| <b>Net Cost</b>   | <u><b>5</b></u>                          | <u><b>53</b></u>  |
| <i><b>Departmental Operations and Other</b></i>           |  |   |
| Gross Cost  | 1,204                                    | 852   |
| Less Earned Revenue                                       | (3)                                      | (2)   |
| <b>Net Cost</b>   | <u><b>1,201</b></u>                      | <u><b>850</b></u>   |
| <i><b>U.S. Secret Service</b></i>                         |  |   |
| Gross Cost  | 1,689                                    | 1,471   |
| Less Earned Revenue                                       | (16)                                     | (18)  |
| <b>Net Cost</b>   | <u><b>1,673</b></u>                      | <u><b>1,453</b></u>   |
| <i><b>Science and Technology Directorate</b></i>          |  |   |
| Gross Cost  | 987                                      | 843   |
| Less Earned Revenue                                       | (14)                                     | -   |
| <b>Net Cost</b>   | <u><b>973</b></u>                        | <u><b>843</b></u>   |
| <i><b>Transportation Security Administration</b></i>      |  |   |
| Gross Cost  | 6,439                                    | 6,001   |
| Less Earned Revenue                                       | (2,299)                                  | (2,477)   |
| <b>Net Cost</b>   | <u><b>4,140</b></u>                      | <u><b>3,524</b></u>   |
| <b>NET COST OF OPERATIONS (Note 23 and 24)</b>            | <u><b>\$42,815</b></u>                   | <u><b>\$54,191</b></u>  |

The accompanying notes are an integral part of these statements.

**Department of Homeland Security**  
**Statements of Changes in Net Position**  
**For the Year Ended September 30, 2007**  
**(In Millions)**

|   | <b><u>2007</u></b><br><b>(Unaudited)</b> |                    |              |                       |
|---|--|--------------------|--------------|-----------------------|
|   | Earmarked<br>Funds                       | All Other<br>Funds | Eliminations | Consolidated<br>Total |
| <b>Cumulative Results of Operations</b>                   |  |                    |              |                       |
| Beginning Balances  | \$(19,337)                               | \$(20,919)         | \$ -         | \$(40,256)            |
| Adjustments:  |  |                    |              |                       |
| Change in Accounting Method (Note 36)                     | 693                                      | -                  | -            | 693                   |
| Beginning Balance, as Adjusted                            | <b>(18,644)</b>                          | <b>(20,919)</b>    | -            | <b>(39,563)</b>       |
| <b>Budgetary Financing Sources</b>                        |  |                    |              |                       |
| Appropriations used                                       | -  | 39,074             | -            | 39,074                |
| Non-exchange Revenue                                      | 3,603                                    | 6                  | -            | 3,609                 |
| Donations and Forfeitures of Cash<br>and Cash Equivalents | 2  | -                  | -            | 2                     |
| Transfers in/out Without Reimbursement                    | (1,980)                                  | 1,855              | -            | (125)                 |
| Other   | -  | (174)              | -            | (174)                 |
| <b>Other Financing Sources (Non-Exchange)</b>             |  |                    |              |                       |
| Donations and forfeitures of property                     | -  | 4                  | -            | 4                     |
| Transfers in/out reimbursement                            | -  | 9                  | -            | 9                     |
| Imputed financing   | 2  | 848                | 11           | 839                   |
| Total Financing Sources                                   | 1,627                                    | 41,622             | 11           | 43,238                |
| Net Cost of Operations                                    | 781                                      | (43,607)           | (11)         | (42,815)              |
| Net Change  | 2,408                                    | (1,985)            | -            | 423                   |
| <b>Cumulative Results of Operations</b>                   | <b>(16,236)</b>                          | <b>(22,904)</b>    | -            | <b>(39,140)</b>       |
| <b>Unexpended Appropriations</b>                          |  |                    |              |                       |
| Beginning Balance   | -  | 48,816             | -            | 48,816                |
| Adjustments:  |  |                    |              |                       |
| Adjustments (Note 37)                                     | -  | 37                 | -            | 37                    |
| Beginning Balance, as Adjusted                            | -  | <b>48,853</b>      | -            | <b>48,853</b>         |
| <b>Budgetary Financing Sources</b>                        |  |                    |              |                       |
| Appropriations Received (Note 31)                         | -  | 39,520             | -            | 39,520                |
| Appropriations Transferred in/out                         | -  | 295                | -            | 295                   |
| Other Adjustments   | -  | (591)              | -            | (591)                 |
| Appropriations Used                                       | -  | (39,074)           | -            | (39,074)              |
| Total Budgetary Financing Sources                         | -  | 150                | -            | 150                   |
| <b>Total Unexpended Appropriations</b>                    | -  | <b>49,003</b>      | -            | <b>49,003</b>         |
| <b>NET POSITION</b>                                       | <b>\$(16,236)</b>                        | <b>\$26,099</b>    | <b>\$ -</b>  | <b>\$9,863</b>        |

The accompanying notes are an integral part of these statements.

**Department of Homeland Security**  
**Statements of Changes in Net Position**  
**For the Year Ended September 30, 2006**  
**(In Millions)**

|   | <b>2006</b>                   |                            |                               |
|---|-------------------------------|----------------------------|-------------------------------|
|   | <b>(Unaudited) (Restated)</b> |                            |                               |
|   | <b>Earmarked<br/>Funds</b>    | <b>All Other<br/>Funds</b> | <b>Consolidated<br/>Total</b> |
| <b>Cumulative Results of Operations</b>                   |                               |                            |                               |
| Beginning Balances  | \$(22,715)                    | \$(19,132)                 | \$(41,847)                    |
| Adjustments:  |                               |                            |                               |
| Corrections of Errors (Note 34)                           | -                             | (588)                      | (588)                         |
| Beginning Balance, as Adjusted                            | (22,715)                      | (19,720)                   | (42,435)                      |
| <b>Budgetary Financing Sources</b>                        |                               |                            |                               |
| Appropriations Used                                       | -                             | 52,872                     | 52,872                        |
| Non-exchange Revenue                                      | 2,516                         | 11                         | 2,527                         |
| Donations and Forfeitures of Cash<br>and Cash Equivalents | 68                            | -                          | 68                            |
| Transfers in/out without Reimbursement                    | (1,296)                       | 1,657                      | 361                           |
| Other   | 2                             | (198)                      | (196)                         |
| <b>Other Financing Sources (Non-Exchange)</b>             |                               |                            |                               |
| Donations and Forfeitures of Property                     | -                             | 6                          | 6                             |
| Transfers in/out Reimbursement                            | -                             | 30                         | 30                            |
| Imputed Financing   | 2                             | 700                        | 702                           |
| Total Financing Sources                                   | 1,292                         | 55,078                     | 56,370                        |
| Net Cost of Operations                                    | 2,086                         | (56,277)                   | (54,191)                      |
| Net Change  | 3,378                         | (1,199)                    | 2,179                         |
| <b>Cumulative Results of Operations</b>                   | <b>(19,337)</b>               | <b>(20,919)</b>            | <b>(40,256)</b>               |
| <b>Unexpended Appropriations</b>                          |                               |                            |                               |
| Beginning Balance   | -                             | 87,131                     | 87,131                        |
| Adjustments:  |                               |                            |                               |
| Corrections of Errors (Note 34)                           | -                             | 676                        | 676                           |
| Beginning Balance, as Adjusted                            | -                             | <b>87,807</b>              | <b>87,807</b>                 |
| <b>Budgetary Financing Sources</b>                        |                               |                            |                               |
| Appropriations Received (Note 31 and 36)                  | -                             | 39,529                     | 39,529                        |
| Appropriations Transferred in/out                         | -                             | (573)                      | (573)                         |
| Other Adjustments   | -                             | (25,075)                   | (25,075)                      |
| Appropriations Used                                       | -                             | (52,872)                   | (52,872)                      |
| Total Budgetary Financing Sources                         | -                             | (38,991)                   | (38,991)                      |
| <b>Total Unexpended Appropriations</b>                    | <b>-</b>                      | <b>48,816</b>              | <b>48,816</b>                 |
| <b>NET POSITION</b>                                       | <b>\$(19,337)</b>             | <b>\$27,897</b>            | <b>\$8,560</b>                |

The accompanying notes are an integral part of these statements.

**Department of Homeland Security**  
**Statements of Budgetary Resources**  
**For the Years Ended September 30, 2007 and 2006**  
(In Millions)

|  | <u>2007</u><br>(Unaudited) | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts | <u>2006</u><br>(Unaudited) (Restated) | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts |
|--|----------------------------|--|---------------------------------------|--|
|  | <u>Budgetary</u>           |  | <u>Budgetary</u>                      |  |
| <b>BUDGETARY RESOURCES</b>                                   |                            |  |                                       |  |
| Unobligated Balance, Brought Forward,<br>October 1 (Note 37) | \$17,313                   | \$ -   | \$56,905                              | \$26   |
| Recoveries of Prior Year Unpaid Obligations                  | 4,938                      | -  | 3,740                                 | -  |
| Budget Authority:  |                            |  |                                       |  |
| Appropriations (Note 31)                                     | 46,491                     | -  | 45,748                                | -  |
| Borrowing Authority  | -                          | -  | 17,500                                | 629  |
| Spending Authority from Offsetting<br>Collections:           |                            |  |                                       |  |
| Earned:  |                            |  |                                       |  |
| Collected  | 9,963                      | 336  | 9,093                                 | 478  |
| Change in Receivables from Federal<br>Sources                | (5)                        | -  | 38                                    | -  |
| Change in Unfilled Customer Orders:                          |                            |  |                                       |  |
| Advances Received  | 78                         | -  | (541)                                 | -  |
| Without Advance From Federal Sources                         | 707                        | (122)  | 186                                   | 481  |
| Expenditure Transfers from Trust Funds                       | 47                         | -  | 49                                    | -  |
| Subtotal   | 57,281                     | 214  | 72,073                                | 1,588  |
| Non-expenditure Transfers, net; Anticipated and<br>Actual    | 787                        | -  | (228)                                 | -  |
| Temporarily Not Available Pursuant to Public<br>Law          | -                          | -  | (24)                                  | -  |
| Permanently Not Available                                    | (671)                      | (70)   | (25,172)                              | (334)  |
| <b>TOTAL BUDGETARY RESOURCES</b>                             | <b><u>\$79,648</u></b>     | <b><u>\$144</u></b>  | <b><u>\$107,294</u></b>               | <b><u>\$1,280</u></b>  |
| <b>STATUS OF BUDGETARY RESOURCES</b>                         |                            |  |                                       |  |
| Obligations Incurred: (Note 25)                              |                            |  |                                       |  |
| Direct   | \$56,669                   | \$13   | \$85,503                              | \$1,280  |
| Reimbursable   | 5,320                      | -  | 4,487                                 | -  |
| Subtotal   | 61,989                     | 13   | 89,990                                | 1,280  |
| Unobligated Balance:   |                            |  |                                       |  |
| Apportioned  | 9,141                      | 12   | 11,854                                | -  |
| Exempt from Apportionment                                    | 97                         | -  | 80                                    | -  |
| Subtotal   | 9,238                      | 12   | 11,934                                | -  |
| Unobligated Balance Not Available                            | 8,421                      | 119  | 5,370                                 | -  |
| <b>TOTAL STATUS OF BUDGETARY<br/>RESOURCES</b>               | <b><u>\$79,648</u></b>     | <b><u>\$144</u></b>  | <b><u>\$107,294</u></b>               | <b><u>\$1,280</u></b>  |



**Department of Homeland Security**  
**Statements of Budgetary Resources**  
**For the Years Ended September 30, 2007 and 2006**  
**(In Millions)**

|  | <u>2007</u><br>(Unaudited) | <u>Non-<br/>Budgetary<br/>Credit<br/>Reform<br/>Financing<br/>Accounts</u> | <u>2006</u><br>(Unaudited) (Restated) | <u>Non-<br/>Budgetary<br/>Credit<br/>Reform<br/>Financing<br/>Accounts</u> |
|--|----------------------------|--|---------------------------------------|--|
|  | <u>Budgetary</u>           |  | <u>Budgetary</u>                      | <u>Accounts</u>  |
| <b>CHANGE IN OBLIGATED BALANCE</b>   |                            |  |                                       |  |
| Obligated Balance, Net   |                            |  |                                       |  |
| Unpaid Obligations Brought Forward,<br>October 1                                     | \$43,036                   | \$642  | \$40,430                              | -  |
| Uncollected Customer Payments from<br>Federal Sources, Brought Forward,<br>October 1 | (2,069)                    | (482)  | (1,845)                               | -  |
| Total Unpaid Obligated Balance, net (Note<br>37)                                     | 40,967                     | 160  | 38,585                                | -  |
| Obligations Incurred, net  | 61,989                     | 13   | 89,990                                | 1,280  |
| Gross Outlays  | (56,293)                   | (175)  | (83,675)                              | (639)  |
| Obligated Balance Transferred, net   |                            |  |                                       |  |
| Actual Transfers, Unpaid Obligations   | (18)                       | -  | -                                     | -  |
| Total Unpaid Obligated Balance<br>Transferred, net                                   | (18)                       | -  | -                                     | -  |
| Recoveries of Prior Year Unpaid Obligations,<br>Actual                               | (4,938)                    | -  | (3,740)                               | -  |
| Change in Uncollected Customer Payments<br>from Federal Sources                      | (702)                      | 121  | (224)                                 | (481)  |
| Obligated Balance, net, End of Period  |                            |  |                                       |  |
| Unpaid Obligations   | 43,775                     | 480  | 43,005                                | 642  |
| Uncollected Customer Payments from<br>Federal Sources                                | (2,770)                    | (361)  | (2,069)                               | (482)  |
| Total, Unpaid Obligated Balance, net, End of<br>Period                               | <u>\$41,005</u>            | <u>\$119</u>   | <u>\$40,936</u>                       | <u>\$160</u>   |
| <b>NET OUTLAYS</b>   |                            |  |                                       |  |
| Gross Outlays  | \$56,293                   | \$175  | \$83,675                              | \$639  |
| Offsetting Collections   | (10,090)                   | (336)  | (8,601)                               | (478)  |
| Distributed Offsetting Receipts  | (4,952)                    | -  | (4,821)                               | -  |
| <b>NET OUTLAYS</b>   | <u>\$41,251</u>            | <u>\$161</u>   | <u>\$70,253</u>                       | <u>\$161</u>   |

The accompanying notes are an integral part of these statements.

**Department of Homeland Security**  
**Statements of Custodial Activity**  
**For the Years Ended September 30, 2007 and 2006**  
**(In Millions)**

|  | <u>2007</u><br><u>(Unaudited)</u> | <u>2006</u><br><u>(Unaudited)</u> |
|--|-----------------------------------|-----------------------------------|
| <b>Revenue Activity</b>                              |                                   |                                   |
| Sources of Cash Collections:                         |                                   |                                   |
| Duties   | \$26,658                          | \$24,730                          |
| User Fees  | 1,732                             | 1,524                             |
| Excise Taxes   | 2,626                             | 2,427                             |
| Fines and Penalties                                  | 60                                | 64                                |
| Interest   | 15                                | 12                                |
| Miscellaneous  | 25                                | 178                               |
| Total Cash Collections                               | 31,116                            | 28,935                            |
| Accrual Adjustments                                  | 5,723                             | (5,371)                           |
| <b>Total Custodial Revenue</b>                       | <b>36,839</b>                     | <b>23,564</b>                     |
| <b>Disposition of Collections</b>                    |                                   |                                   |
| Transferred to Others:                               |                                   |                                   |
| Federal Entities:                                    |                                   |                                   |
| U.S. Department of Agriculture                       | 148                               | 127                               |
| U.S. Department of Labor                             | 193                               | 189                               |
| U.S. Department of State                             | 46                                | 44                                |
| National Science Foundation                          | 107                               | 105                               |
| Treasury General Fund Accounts                       | 23,591                            | 27,206                            |
| Other Federal Agencies                               | 21                                | 17                                |
| Non-Federal Entities:                                |                                   |                                   |
| Government of Puerto Rico                            | 14                                | 14                                |
| Government of the U.S. Virgin Islands                | 5                                 | 6                                 |
| Other Non-Federal Entities                           | 20                                | 9                                 |
| (Increase)/Decrease in Amounts Yet to be Transferred | 5,712                             | (5,371)                           |
| Refunds and Drawbacks (Notes 18 and 32)              | 6,922                             | 1,160                             |
| Retained by the Department                           | 60                                | 58                                |
| <b>Total Disposition of Custodial Revenue</b>        | <b>36,839</b>                     | <b>23,564</b>                     |
| <b>Net Custodial Activity</b>                        | <b>\$ -</b>                       | <b>\$ -</b>                       |

The accompanying notes are an integral part of these statements.

## Notes to the Financial Statements (Unaudited)

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## Notes to the Financial Statements (Unaudited)

### 1. Summary of Significant Accounting Policies

#### A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002 (HSA)*, P.L. 107-296, dated March 25, 2002, as an executive department of the U.S. Federal Government. DHS's mission is to lead the national effort to secure America. This mission includes the prevention and deterrence of terrorist attacks and protection against, and response to, threats and hazards to the Nation and critical infrastructure from dangerous people and goods. Additionally, DHS's mission is to ensure the safety and security of borders, welcome lawful immigrants and visitors, and promote the free-flow of commerce. In support of DHS's mission, the Secretary has established additional goals to build a nimble, effective emergency response system and a culture of preparedness, and to strengthen and unify DHS operations and management. The Department is composed of the following financial reporting Components<sup>1</sup>:

- **Federal Emergency Management Agency (FEMA)**
- **National Protection and Programs Directorate (NPPD)**
- **Science and Technology Directorate (S&T)**
- **U.S. Citizenship and Immigration Services (USCIS)**
- **U.S. Coast Guard (USCG)**
- **U.S. Customs and Border Protection (CBP)**
- **Federal Law Enforcement Training Center (FLETC)**
- **U.S. Immigration and Customs Enforcement (ICE)**, including the Federal Protective Services (FPS)
- **U.S. Secret Service (USSS)**
- **Transportation Security Administration (TSA)**
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), Office of Intelligence and Analysis, and the Office of Operations Coordination

On October 4, 2006, the President signed the *Post-Katrina Emergency Management Reform Act of 2006 (P.L. 109-295)* (the PKEMR Act) which is codified at Title VI of the Department's FY 2007 Appropriations Act (P.L. 109-295). The PKEMR Act established various positions within DHS, brought additional functions into FEMA, and created and reallocated functions to other Components within DHS. In addition, pursuant to the Secretary's Authority under Section 872, *Reorganization Authority of the Homeland Security Act of 2002* (the Reorganization Authority under the HSA), DHS has made certain other organizational changes outside of the PKEMR Act. All changes as a result of the PKEMR Act and the Reorganization Authority under the HSA were effective as of March 31, 2007, unless otherwise noted.

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<sup>1</sup> Financial reporting components are to be distinguished from direct report components.



As a result of the PKEMR Act:

- FEMA was expanded to include some programs from the Preparedness Directorate, including: the Office of Grants and Training (G&T); the Radiological Emergency Preparedness Program (REPP); and the United States Fire Administration (USFA).
- A new Office of Emergency Communications (OEC) was established and reports directly to the Assistant Secretary for Cyber Security and Communication within NPPD.

Pursuant to the Reorganization Authority under the HSA:

- The Preparedness Directorate was renamed the National Protection and Programs Directorate (NPPD). The new NPPD includes the following offices: Office of the Under Secretary, Office of Infrastructure Protection, Office of Risk Management and Analysis, Office of Cyber Security and Communications, Office of Intergovernmental Programs, and the US-VISIT program.
- The Office of Health Affairs (OHA) was established and is comprised of the Office of the Chief Medical Officer and offices responsible for carrying out the Department's biodefense responsibilities.

During FY 2007, the Department began reporting the Sport Fish Restoration and Boating Trust Fund (SFRBTF) in the applicable financial statements and footnotes based on the updated A-136 requirements for the reporting of mixed funds (partially earmarked and partially non-earmarked). The SFRBTF is a Treasury managed trust fund. During FY 2006 and prior, the SFRBTF was reported by the Department of the Interior.

## **B. Basis of Presentation**

These financial statements are prepared to report the consolidated financial position, net cost of operation, changes in net position, custodial activity, and the combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994 (P.L. 103-356)* and *Chief Financial Officers Act of 1990 (P.L. 101-576)*, as amended by the *Reports Consolidation Act of 2000 (P.L. 106-531)*.

The Department's financial statements have been prepared from the accounting records of the Department in conformity with U.S. Generally Accepted Accounting Principles (GAAP), and the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), the official accounting standards-setting body of the Federal Government.

The Department's financial statements reflect the reporting of Departmental activities including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department on behalf of the Federal Government.

Intragovernmental assets and liabilities result from activity with other Federal entities. All other assets and liabilities result from activity with parties outside the Federal Government, such as

domestic and foreign persons, organizations, or governments. Intragovernmental earned revenues are collections or accruals of revenue from other Federal entities and intragovernmental costs are payments or accruals to other Federal entities. Transactions and balances among the Department's Components have been eliminated in the consolidated presentation of the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Statements of Custodial Activity. The Statements of Budgetary Resources are reported on a combined basis; therefore, intradepartmental balances have not been eliminated.

While these financial statements have been prepared from the books and records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the U.S. Government acting in its capacity as a sovereign entity.

**Reclassifications.** The PKEMR Act and the Reorganization Authority under HSA caused changes affecting the definition of the Reporting Entity. Therefore, certain reclassifications were made to the FY 2006 financial statements and associated footnotes to conform with the FY 2007 presentation.

### **C. Basis of Accounting**

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of when cash is exchanged. Budgetary accounting facilitates compliance with legal constraints and the controls over the use of Federal funds. The balances and activity of budgetary accounts are used to prepare the Statements of Budgetary Resources. The Statements of Custodial Activity are reported using the modified cash basis. With this method, revenue from cash collections is reported separately from receivable accruals and cash disbursements are reported separately from payable accruals.

### **D. Use of Estimates**

Management has made certain estimates and assumptions in the reporting of assets, liabilities, revenues, expenses, obligations incurred, spending authority from offsetting collections, and note disclosures in the financial statements. Actual results could differ from these estimates. Significant estimates include: the year-end accruals of accounts and grants payable; contingent legal and environmental liabilities; accrued workers' compensation; allowance for doubtful accounts receivable; allowances for obsolete inventory and operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial workers compensation assumptions; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

## **E. Entity and Non-Entity Assets**

Entity assets are assets that the Department has the authority to use in its operations. The authority to use funds in an entity's operations means that Department management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations, e.g. salaries and benefits.

Non-entity assets are assets held by the Department, but are not available for use by the Department. An example of a non-entity asset is Fund Balance with Treasury which consists of special and deposit funds, permanent appropriations, and miscellaneous receipts that are available to pay non-entity liabilities.

## **F. Fund Balance with Treasury**

Fund Balance with Treasury represents the aggregate amount of the Department's accounts with the U.S. Department of the Treasury (Treasury) available to pay current liabilities and finance authorized purchases, except as restricted by law. The Department's Fund Balance with Treasury balances are primarily appropriated, revolving, trust, deposit, receipt, and special fund amounts remaining as of the fiscal year-end.

For additional information, see Note 3, Fund Balance with Treasury.

## **G. Cash and Other Monetary Assets**

The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, cash held by insurance companies, and seized cash and monetary instruments.

The Department does not maintain cash in commercial bank accounts. For FEMA, certain receipts are received and processed by insurance companies. The remainder of the receipts and disbursements are processed by Treasury.

For additional information, see Note 4, Cash and Other Monetary Assets.

## **H. Investments, Net**

Investments consist of U.S. Government non-marketable par value and market based Treasury securities, and are reported at cost or amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method or the straight line method, which approximates the interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold these investments to maturity.

For additional information, see Note 5, Investments, Net.

## **I. Accounts Receivable, Net**

Accounts receivable represent amounts due to the Department from other Federal agencies and the public. Intragovernmental accounts receivable generally arise from the provision of goods and services to other Federal agencies and are expected to be fully collected.

Accounts receivable due from the public typically results from various immigration and user fees, premiums and restitution from insurance companies and policyholders, breached bonds, reimbursable services, and security fees. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analysis of past due receivables, or historical collection experience. Interest due on past due receivables is fully reserved until collected.

For additional information, see Note 6, Accounts Receivable, Net.

## **J. Advances and Prepayments**

Intragovernmental advances, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance advances to other Federal agencies tasked with mission assignments.

Advances and prepayments to the public, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance grants to States and other grant activity. Advances are expensed as they are used by the recipients. At year-end, the amount, if any, of grant funding unexpended and a grant payable is estimated based on cash transactions reported by the grant administrator.

For additional information, see Note 13, Other Assets.

## **K. Direct Loans, Net**

Direct loans are loans issued by the Department to local governments. FEMA, the only DHS Component with loan activity, operates the Community Disaster Loan program to support any local government which has suffered a substantial loss of tax and other revenues as a result of a major disaster and which demonstrates a need for Federal financial assistance in order to perform its governmental functions. Under the program, FEMA transacts direct loans to local governments who meet statutorily set eligibility criteria. Loans are accounted for as receivables as funds are disbursed.

All of the Department's loans are post-1991 obligated direct loans, and the resulting receivables are governed by the *Federal Credit Reform Act of 1990 (FCRA) (P.L. 101-508)*. Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are an estimated long-term cost to the U.S. Government for its loan programs. The subsidy cost is equal to the present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. Administrative costs such as salaries and contractual fees are not included. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and

defaults, and other cash flows. The Department calculates the subsidy costs based on a subsidy calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated net cash flows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recorded in the allowance for subsidy, which is estimated and adjusted annually, as of year-end. Interest receivable is the total interest that has accrued on each of the outstanding loans, less any cancellations that may have been recorded due to the FEMA cancellation policy as described in 44 CFR Section 206.366.

For additional information see Note 8, Direct Loans, net.

## **L. Inventory and Related Property, Net**

OM&S are tangible personal property consumed during normal operations. Department OM&S consists primarily of goods consumed during the service of vessels and aircraft. OM&S are valued based on an average unit cost, weighted moving average method, or on actual prices paid. OM&S are expensed when consumed or issued for use. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance, which is based on the condition of various asset categories, as well as historical experience with using and disposing of such assets.

Inventory is tangible personal property that is held for sale, in the process of production for sale, or to be consumed in the production of goods for sale, or in the provision of services for fees. Department inventories consist primarily of USCG Supply Fund's uniform clothing, subsistence provisions, retail stores, general stores, technical material and fuel, and USCG Yard Fund's ship repair and general inventory. Inventories on hand at year-end are stated at cost using standard price/specific identification, last acquisition price, or weighted average cost methods, which approximates historical cost. Revenue on inventory sales and associated cost of goods sold are recorded when merchandise is sold to the end user.

Stockpile materials are critical materials held due to statutory requirements for use in national emergencies. The Department's stockpile materials held by FEMA include goods that would be used to respond to national disasters, including water, meals, cots, and blankets. The goods are valued at historical cost.

For additional information see Note 9, Inventory and Related Property, Net

## **M. Seized and Forfeited Property**

The Department's prohibited seized property results primarily from criminal investigations and passenger/cargo processing. Seized property falls into two categories, prohibited and non-prohibited. Prohibited seized property includes illegal drugs, contraband, and counterfeit items that cannot legally enter into the commerce of the United States; non-prohibited seized property includes items that are not inherently illegal to possess or own such as monetary instruments, real property, and tangible personal property of others.

Seized property is not considered an asset of the Department and is not reported as such in the Department's financial statements. However, the Department has a stewardship responsibility

until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized.

Forfeited property is seized property for which the title has passed to the U.S. Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the Department until disposed of or destroyed. Non-prohibited forfeited property is transferred to the Treasury Forfeiture Fund.

An analysis of changes in seized and forfeited property of prohibited items is presented in Note 10.

#### **N. General Property, Plant, and Equipment, Net**

The Department's property, plant, and equipment (PP&E) consists of aircraft, vessels, vehicles, land, structures, facilities, capital leases, leasehold improvements, software, information technology, and other equipment. PP&E is recorded at cost. The Department capitalizes PP&E acquisitions when the cost equals or exceeds an established threshold and has a useful life of two years or more.

Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) costs, plus applied overhead and other indirect costs. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

Internal use software includes purchased commercial off-the-shelf software (COTS), contractor developed software, and internally developed software. For COTS software, the capitalized costs include the amount paid to the vendor for the software. For contractor developed software the capitalized costs include the amount paid to a contractor to design, program, install, and implement the software. Capitalized costs for internally developed software include the full cost (direct and indirect) incurred during the software development phase.

The schedule of capitalization thresholds shown below is a summary of the range of capitalization rules in place from the legacy agencies that comprised the Department. In accordance with DHS policy, Components were allowed to continue using their legacy thresholds and capitalization rules until a more comprehensive approach is developed that takes into account the vast differences in Component size and asset usage.



The ranges of capitalization thresholds and service life used by Components, by primary asset category, are as follows:

| <b>Asset Description</b>     | <b>Capitalization Threshold</b> | <b>Service Life</b> |
|------------------------------|---------------------------------|---------------------|
| Land                         | Regardless of cost to \$100,000 | Not Applicable      |
| Improvements to Land         | Regardless of cost to \$100,000 | 3 years to 50 years |
| Buildings and improvement    | Regardless of cost to \$200,000 | 2 years to 50 years |
| Equipment and capital leases | \$5,000 to \$200,000            | 2 years to 65 years |
| Software                     | \$5,000 to \$750,000            | 2 years to 10 years |

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation is calculated on a straight-line method for all asset classes over their estimated useful lives. Land is not depreciated. Leasehold improvements are depreciated over the shorter of the term of the remaining portion of the lease or the useful life of the improvement. Buildings and equipment acquired under capital leases are amortized over the lease term. Amortization of capitalized software is calculated using the straight-line method and begins on the date of acquisition if purchased, or when the module or component has been placed in use (i.e., successfully installed and tested) if contractor or internally developed. There are no restrictions on the use or convertibility of general PP&E.

For additional information see Note 11, General Property, Plant and Equipment, Net.

## **O. Stewardship Property, Plant and Equipment**

Stewardship PP&E includes heritage assets and stewardship land which generally are not included in general PP&E presented on the Balance Sheet. Heritage assets are unique due to their historical or natural significance, cultural, educational, or artistic importance, or significant architectural characteristics. The Department's heritage assets consist primarily of buildings and structures owned by USCG. Due to their nature, heritage assets are not depreciated because matching costs with specific periods would not be meaningful.

Heritage assets can serve two purposes: a heritage function and general government operational function. If a heritage asset serves both purposes, but is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset, which is included in general PP&E on the Balance Sheet. The Department's multi-use heritage assets consist primarily of buildings and structures owned by CBP and USCG. DHS depreciates its multi-use heritage assets.

For more information see Note 12, Stewardship Property, Plant and Equipment.

## **P. Liabilities**

Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available Congressionally appropriated funds or other amounts, and there is no certainty

that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can abrogate liabilities of the Department arising from other than contracts.

## **Q. Contingent Liabilities**

Certain conditions exist as of the date of the financial statements, which may result in a loss to the government, but which will only be resolved when one or more future events occur or fail to occur. The Department recognizes a loss contingency when the future outflow or other sacrifice of resources is probable and reasonably estimable. The Department discloses a loss contingency in the notes to the financial statements when the conditions for liability recognition are not met, but a loss from the outcome of future events is more than remote.

For more information see Note 21, Commitments and Contingent Liabilities.

**Environmental Cleanup Costs.** Environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated asset into compliance with applicable environmental standards. Accruals for environmental cleanup costs are the costs of removing, containing, and/or disposing of hazardous wastes or materials that, because of quantity, concentration, or physical or chemical characteristics, may pose a substantial present or potential hazard to human health or the environment.

For all PP&E in service as of October 1, 1997, DHS recognizes the estimated total cleanup costs associated with the PP&E at the time the cleanup requirement is identified. DHS does not prorate a cleanup cost over the life of these PP&E. However, the estimate may be subsequently adjusted for material changes due to inflation/deflation or changes in regulations, plans, or technology. The applicable costs of decommissioning DHS's existing and future vessels are considered cleanup costs.

For more information see Note 17, Environmental and Disposal Liabilities.

## **R. Grants Liabilities**

The Department awards grants and cooperative agreements to Federal, State, and local governments, universities, non-profit organizations, and private sector companies for the purpose of building the capacity to respond to disasters and emergencies, conduct research into preparedness, enhance and ensure the security of passenger and cargo transportation by air, land, or sea, and other Department-related activities. The Department estimates the year-end grant accrual for unreported grantee expenditures using historical disbursement data. Grants liabilities are combined with accounts payable to the public in the accompanying Balance Sheets.

## **S. Insurance Liabilities**

Insurance liabilities are the result of the Department's sale or continuation-in-force of flood insurance known as the NFIP, which is managed by FEMA. The insurance liability represents an estimate of NFIP losses that are unpaid at the Balance Sheet date. Although the insurance underwriting operations believes the liability for unpaid losses and loss adjustment expenses is reasonable and adequate in the circumstances, actual incurred losses and loss adjustment expenses

may not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the estimate reported in the financial statements.

For more information see Note 18, Other Liabilities, and Note 20, Insurance Liabilities.

## **T. Debt and Borrowing Authority**

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations. The Department's obligations for NFIP and DADLP are financed by principal repayments, flood premiums, and map collection fees.

The Department has borrowing authority for NFIP and DADLP, and may obtain additional borrowing authority if approved.

For more information see Note 15, Debt.

## **U. Accrued Payroll and Benefits**

**Accrued Payroll.** Accrued Payroll consists of salaries, wages, and other compensation earned by the employees, but not disbursed as of September 30. The liability is estimated for reporting purposes based on historical pay information.

**Leave Program.** Earned annual and other vested compensatory leave is accrued as it is earned and reported on the Balance Sheet as an accrued payroll and benefits liability. The liability is reduced as leave is taken. Each year, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances. Sick leave and other types of non-vested leave are not earned benefits. Accordingly, non-vested leave is expensed when used.

**Federal Employees Compensation Act.** The *Federal Employees Compensation Act (FECA)* (P.L. 103-3) provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (Labor), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two components. The first component, accrued FECA liability, is based on actual claims paid by Labor but not yet reimbursed by the Department. The Department reimburses Labor for the amount of actual claims as funds are appropriated for this purpose. There is generally a two to three-year time period between payment by Labor and reimbursement to Labor by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by Labor and to be reimbursed by the Department.

The second component, actuarial FECA liability, is the estimated liability for future benefit payments and is recorded as a component of Federal Employee and Veterans' Benefits. This liability includes death, disability, medical, and miscellaneous costs. Labor determines this

component annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using the OMB economic assumptions for ten year Treasury notes and bonds. The actuarial FECA liability is not covered by budgetary resources and will require future funding.

For more information on the Actuarial FECA Liability see Note 16, Federal Employee and Veterans' Benefits. For more information on the Accrued FECA Liability, Accrued Payroll and Accrued Leave, see Note 18, Other Liabilities.

## **V. Federal Employee and Veterans' Benefits**

***Civilian Pension and Other Post Employment Benefits.*** The Department recognizes the full annual cost of its civilian employees' pension benefits; however, the assets of the plan and liability associated with pension costs are recognized by Office of Personnel Management (OPM) rather than the Department.

Most U.S. Government employees of DHS hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes 7 percent of base pay for regular CSRS employees, and 7.5 percent of base pay for law enforcement agents. The majority of employees hired after December 31, 1983, are covered by the Federal Employees Retirement System (FERS) and Social Security. For the FERS basic annuity benefit the Department contributes 11.2 percent of base pay for regular FERS employees and 23.8 percent for law enforcement agents. A primary feature of FERS is that it also offers a defined contribution plan to which the Department automatically contributes 1 percent of base pay and matches employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's Social Security matching share for FERS participants.

Similar to CSRS and FERS, OPM rather than the Department reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHB) and Federal Employees Group Life Insurance Program (FEGLI). The Department is required to report the full annual cost of providing these other retirement benefits (ORB) for its retired employees as well as reporting contributions made for active employees. In addition, the Department recognizes an expense and liability for other post employment benefits (OPEB), which includes all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

The difference between the full annual cost of CSRS and FERS retirement, ORB, and OPEB and the amount paid by the Department is recorded as an imputed cost and offsetting imputed financing source in the accompanying financial statements.

***Military Retirement System Liability.*** The USCG Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all retired active duty and reserve military members of the USCG. The plan is funded through annual appropriations and, as such, is a pay-as-you-go system. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of the future

cost of benefits. Current period expense is computed using the aggregate entry age normal actuarial cost method.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible and Medicare eligible retirees/survivors. The Department of Defense (DOD) is the administrative entity for the Medicare eligible fund (Fund), and in accordance with SFFAS No. 5, is required to recognize the liability on the Fund's financial statements. The USCG makes annual payments to the Fund for current active duty members. Benefits for USCG members who retired prior to the establishment of the Fund are provided by payments from the Treasury to the Fund. The future cost and liability of the Fund is determined using claim factors and claims cost data developed by DOD, adjusted for USCG retiree and actual claims experience. The USCG uses the current year actual costs to project costs for all future years.

**Post-employment Military Travel Benefit.** USCG uniformed service members are entitled to travel and transportation allowances for travel performed or to be performed under orders upon separation from the service, including the member's termination, retirement, permanent disability, or pre-retirement death in service. These allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

USCG recognizes an expense and a liability for this OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. The OPEB liability is measured at the present value of future payments, which requires USCG to estimate the amount and timing of future payments, and to discount the future outflow using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are made.

**Uniformed Division and Special Agent Pension Liability.** The District of Columbia Police and Fireman's Retirement System (the DC Pension Plan) is a defined benefit plan that covers USSS Uniformed Division and Special Agents. The DC Pension Plan makes benefit payments to retirees and/or their beneficiaries. USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.

For more information on Civilian Pension and OPEB, MRS Liability, Post-employment Military Travel Benefits, and Uniformed Division and Special Agent Pension Liability see Note 16, Federal Employee and Veterans' Benefits.

## **W. Earmarked Funds**

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the Federal Government's general revenues.

Earmarked non-exchange revenue and other financing sources, including appropriations and net cost of operations, are shown separately on the Statements of Changes in Net Position. The portion of cumulative results of operations attributable to earmarked funds is shown separately on both the Statements of Changes in Net Position and the Balance Sheets.

For additional information see Note 22, Earmarked Funds, and Note 5, Investments, Net.

## **X. Revenue and Financing Sources**

**Appropriations.** The Department receives the majority of funding to support its programs through Congressional appropriations. The Department receives annual, multi-year, and no-year appropriations that may be used, within statutory limits, for operating and capital expenditures. Additional funding is obtained through exchange revenues, non-exchange revenues and transfers-in.

Appropriations are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements is recognized when the goods or services are provided by the Department. Prices for goods and services sold to the public are based on recovery of full cost or are set at a market price. Reimbursable work between Federal agencies is subject to the *Economy Act (31 United States Code (U.S.C.) 1535)* or other statutes authorizing reimbursement. Prices for goods and services sold to other Federal Government agencies are generally limited to the recovery of direct cost.

**Allocation Transfers.** The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The Department allocates funds, as the parent, to the Department of Health and Human Services (HHS). DHS receives allocation transfers, as the child, from the General Services Administration (GSA), the Department of Transportation, and the Environmental Protection Agency.

**Exchange and Non-Exchange Revenue.** Exchange revenues are recognized when earned and are derived from transactions where both the government and the other party receive value; i.e., goods have been delivered or services have been rendered. Non-exchange revenues from user fees are recognized as earned in accordance with the *Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272)*, as amended. Non-exchange revenues also arise from transfers-in with and without financing sources and donations from the public. Other financing sources, such as donations and transfers of assets without reimbursements, are recognized on the Statements of Changes in Net Position during the period in which the donations and transfers occurred.



Deferred revenue is recorded when the Department receives payment for goods or services which have not been fully rendered. Deferred revenue is reported as a liability on the Balance Sheets until earned. Information and specific examples of deferred revenue include:

- Fees for flood mitigation products and services, such as insurance provided through FEMA's NFIP, are established at rates necessary to sustain a self-supporting program. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums reserved to provide for the remaining period of insurance coverage.
- USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits. A major portion of the revenue received for certain applicant types is deferred and not considered earned until the application is adjudicated.

**Imputed Financing Sources.** In certain instances, operating costs of DHS are paid out of funds appropriated to other Federal agencies. For example, OPM, by law, pays certain costs of retirement programs, and certain legal judgments against DHS are paid from a Judgment Fund maintained by the Treasury. When costs that are identifiable to DHS and directly attributable to DHS operations are paid by other agencies, DHS recognizes these amounts as operating expenses. DHS also recognizes an imputed financing source on the Statements of Changes in Net Position to indicate the funding of DHS operations by other Federal agencies.

**Custodial Revenue.** Non-entity revenue and refunds are reported on the Statements of Custodial Activity using a modified cash basis. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. Duties, user fees, fines and penalties are assessed pursuant to the provisions of Title 19 United States Code (U.S.C.); nonimmigrant petition fees under Title 8 U.S.C., and excise taxes under Title 26 U.S.C. CBP also enforces over 400 laws and regulations some of which require the collection of fees or the imposition of fines and penalties pursuant to other Titles within the U.S.C. or Code of Federal Regulations (C.F.R.).

CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. Non-entity tax and trade accounts receivables are recognized when CBP is entitled to collect duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity on behalf of the Federal Government that have been established as a specifically identifiable, legally enforceable claim and remain uncollected as of year-end. The custodial revenue is recorded at the time of collection. These revenue collections primarily result from current fiscal year activities. Generally, CBP records an equal and offsetting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivable and custodial revenue. CBP accrues an estimate of duties, taxes, and fees related to commerce released prior to year-end where receipt of payment is anticipated subsequent to year-end. Fees collected by USCIS for nonimmigrant petitions must be submitted with the petition. The portions of the fees that are subsequently remitted to other Federal agencies are recorded as custodial revenue at the time of collection.

Non-entity receivables are presented net of amounts deemed uncollectible. CBP tracks and enforces payment of estimated duties, taxes and fees receivable by establishing a liquidated

damage case that generally results in fines and penalties receivable. A fine or penalty, including interest on past due balances, is established when a violation of import/export law is discovered. An allowance for doubtful collections is established for substantially all accrued fines and penalties and related interest. The amount is based on past experience in resolving disputed assessments, the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties and an analysis of aged receivable activity. CBP regulations allow importers to dispute the assessment of duties, taxes, and fees. Receivables related to disputed assessments are not recorded until the protest period expires or a protest decision is rendered in CBP's favor.

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks. Disbursements are recorded as a decrease in the amount Transferred to Federal Entities as reported on the Statement of Custodial Activity. An accrual adjustment is recorded on the Statements of Custodial Activity to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable at year-end.

For additional information see Note 7, Taxes, Duties, and Trade Receivables, Net, and Note 32, Custodial Activities.

## **Y. Taxes**

The Department, as a Federal agency, is not subject to Federal, State, or local income taxes and accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

## **Z. Restatements**

In FY 2007, the Department restated certain FY 2006 balances. For additional information see Note 34, Restatements.

## 2. Non-Entity Assets

Non-entity assets at September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Intragovernmental:                          |                     |                                   |
| Fund Balance with Treasury                  | \$1,130             | \$ 5,949                          |
| Due From Treasury                           | 176                 | 411                               |
| Total Intragovernmental                     | 1,306               | 6,360                             |
| Cash and Other Monetary Assets              | 48                  | 46                                |
| Accounts Receivable, Net                    | 17                  | 19                                |
| Taxes, Duties, and Trade Receivables, Net   | 1,937               | 1,755                             |
| General Property, Plant, and Equipment, Net | -                   | 3                                 |
| Total Public                                | 2,002               | 1,823                             |
| Total Non-Entity Assets                     | 3,308               | 8,183                             |
| Total Entity Assets                         | 75,488              | 71,166                            |
| <b>Total Assets</b>                         | <b>\$78,796</b>     | <b>\$ 79,349</b>                  |

Non-entity Fund Balance with Treasury consists of special and deposit funds, permanent and indefinite appropriations, and miscellaneous receipts that are available to pay non-entity liabilities included in the Balance Sheet. Non-entity Fund Balance with Treasury at September 30, 2007, includes (in special fund) balances for Injured Domestic Industries (IDI) as defined in Note 18. Non-entity Fund Balance with Treasury at September 30, 2006, includes (in deposit fund) approximately \$5.2 billion of unliquidated duties collected by CBP on imports of Canadian Softwood lumber. During FY 2007, approximately \$5 billion in refund disbursements were paid for antidumping and countervailing duties on Canadian Softwood lumber imports. All non-entity Fund Balance with Treasury is considered restricted cash. These assets offset accrued liabilities at September 30, 2007, and 2006 (see Notes 3 and 18).

Non-entity receivables due from Treasury represent an estimate of duty, tax, and/or fee refunds and drawbacks that will be reimbursed by a permanent and indefinite appropriation account and will be used to pay estimated refunds and drawbacks payable. Duties and taxes receivable from the public represents amounts due from importers for goods and merchandise imported to the United States, and upon collection, will be available to pay the accrued intragovernmental liability due to the Treasury General Fund of \$2.1 billion and \$1.8 billion at September 30, 2007 and 2006, respectively (see Notes 7 and 18).

### 3. Fund Balance with Treasury

#### A. Fund Balance with Treasury

Fund Balance with Treasury at September 30 consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Appropriated Funds   | \$50,764            | \$50,899                          |
| Trust Funds  | 60                  | 35                                |
| Revolving, Public Enterprise, and Working<br>Capital Funds | 969                 | 216                               |
| Special Funds  | 3,563               | 2,909                             |
| Deposit Funds  | 829                 | 5,510                             |
| <b>Total Fund Balance with Treasury</b>                    | <b>\$56,185</b>     | <b>\$59,569</b>                   |

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds included clearing funds totaling \$105 million and \$110 million at September 30, 2007 and 2006, respectively, which represent reconciling differences with Treasury balances.

Trust funds include both receipt accounts and expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, generally to offset the cost of expanding border and port enforcement activities and oil spill related claims and activities.

Revolving funds are used for continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components. Also included are the financing funds for credit reform and the National Flood Insurance Fund.

Special funds include funds designated for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders due to qualifying IDI. The Department also has special funds for immigration and naturalization user fees and CBP user fees, as well as inspection fees, flood map modernization subsidy, and off-set and refund transfers. For additional information, see Note 22, Earmarked Funds.

Deposit funds represent amounts received as an advance that are not accompanied by an order and include non-entity collections that do not belong to the Federal Government. At September 30, 2006 the majority of the deposit fund balance relates to unliquidated antidumping and countervailing duties collected by CBP, mostly related to Canadian Softwood lumber. During FY 2007, the deposit fund balance related to antidumping and countervailing duties on Canadian Softwood lumber imports was liquidated, which accounts for the decrease to the deposit fund.

**B. Status of Fund Balance with Treasury**

The status of Fund Balance with Treasury at September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Budgetary Status                                |                     |                                   |
| Unobligated Balances:                           |                     |                                   |
| Available                                       | \$9,250             | \$11,934                          |
| Unavailable                                     | 8,540               | 5,370                             |
| Obligated Balance Not Yet Disbursed             | 41,124              | 41,096                            |
| Total Budgetary Status                          | 58,914              | 58,400                            |
| Reconciling Adjustments:                        |                     |                                   |
| Receipt, Clearing, and Deposit Funds            | 941                 | 5,629                             |
| Borrowing Authority                             | (3,465)             | (4,230)                           |
| Investments                                     | (2,767)             | (628)                             |
| Receivable Transfers and Imprest Fund           | (130)               | (97)                              |
| Receipts unavailable for obligation             | 1,566               | 495                               |
| Authority Temporarily Precluded from Obligation | 25                  | -                                 |
| Accounts Payable - SFRBTF                       | 1,101               | -                                 |
| <b>Total Fund Balance with Treasury</b>         | <b>\$56,185</b>     | <b>\$59,569</b>                   |

Adjustments required to reconcile the budgetary status to non-budgetary Fund Balance with Treasury as reported in the accompanying Balance Sheets are as follows:

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2007 and 2006. Included in the 2006 adjustments for deposit funds are restricted balances for unliquidated antidumping and countervailing duties non-entity funds and receipts that are not available for obligation. During FY 2007, the deposit fund balance related to antidumping and countervailing duties on Canadian Softwood lumber imports was liquidated which accounts for the decrease to the reconciling adjustment.
- Borrowing authority is in budgetary status for use by FEMA for disaster relief purposes and Community disaster loans.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments. The increase in this reconciling adjustment relates to the addition of SFRBTF investments in FY 2007, as well as the accounts payable transfers above.

- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized and obligations may be incurred before the actual transfer of funds.
- Imprest funds represent monies moved from Fund Balance with Treasury to Cash and Other Monetary Assets with no change in the budgetary status.
- Receipts immediately upon collection are unavailable for obligation. The receipts are not available for obligation until a specified time in the future. The increase in this reconciling adjustment relates to the addition of SFRBTF.

Portions of the Unobligated Balances Available, Unavailable and Obligated Balance Not Yet Disbursed contain CBP's user fees of \$730 million and \$761 million at September 30, 2007 and 2006, respectively, which is restricted by law in its use to offset costs incurred by CBP. Further, the Unobligated Balances Available include appropriations received in the Disaster Relief Fund for Hurricane Katrina. As of September 30, 2007 and 2006, this fund has an unobligated balance available of \$4.4 billion and \$5.5 billion, respectively.

Portions of the Unobligated Balance Unavailable include amounts appropriated in prior fiscal years that are not available to fund new obligations. However, it can be used for upward and downward adjustments for existing obligations in future years. The increase in Unobligated Balances Unavailable relates to the increase in appropriations received in the Border Security Infrastructure and Technology Fund and the cancellation of a contract and a reimbursable agreement with HHS.

The Obligated Balance Not Yet Disbursed represents amounts designated for payment of goods and services ordered but not received or goods and services received but for which payment has not yet been made.

#### 4. Cash and Other Monetary Assets

Cash and Other Monetary Assets at September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Cash  | \$282               | \$62                              |
| Seized Monetary Instruments                 | 39                  | 37                                |
| <b>Total Cash and Other Monetary Assets</b> | <b>\$321</b>        | <b>\$99</b>                       |

DHS Cash includes cash held by others, including the net balance maintained by insurance companies for flood insurance premiums received from policyholders, less amounts paid for insured losses; imprest funds; and undeposited cash, which represents fees collected but not yet deposited. An announced increase in immigration application fees and a demand for preference visa categories, which became available under the Department of State's July 2007 Visa Bulletin, combined to create a large increase in immigration applications, resulting in an increase in immigration application fees collected but not yet deposited. Seized Monetary Instruments are



held until disposition and relate primarily to gold coins seized at the end of FY 2004. As of September 30, 2007 and 2006, restricted cash and other monetary assets is \$48 and \$46 million, respectively.

## 5. Investments, Net

Investments at September 30, 2007, consisted of the following (in millions) (unaudited):

| Type of Investment:                       | Amortization Method       | Cost           | Amortized (Premium) Discount | Investments, Net (Unaudited) | Market Value Disclosure |
|---|---------------------------|----------------|------------------------------|------------------------------|-------------------------|
| <i>Intragovernmental Securities:</i>      |                           |                |                              |                              |                         |
| Oil Spill Liability Trust Fund            | Effective interest method | \$925          | \$(7)                        | \$918                        | N/A                     |
| Sport Fish Restoration Boating Trust Fund | Effective interest method | 1,841          | 5                            | 1,846                        | N/A                     |
| Total Non-Marketable                      |                           | 2,766          | (2)                          | 2,764                        | N/A                     |
| Non-Marketable, Market-Based              | Straight line method      | 14             | -                            | 14                           | 14                      |
| <b>Total Investments, Net</b>             |                           | <b>\$2,780</b> | <b>\$(2)</b>                 | <b>\$2,778</b>               | <b>N/A</b>              |

Investments at September 30, 2006, consisted of the following (in millions) (unaudited and restated):

| Type of Investment:                  | Amortization Method       | Cost          | Amortized (Premium) Discount | Investments, Net (Unaudited) | Market Value Disclosure |
|--------------------------------------|---------------------------|---------------|------------------------------|------------------------------|-------------------------|
| <i>Intragovernmental Securities:</i> |                           |               |                              |                              |                         |
| Oil Spill Liability Trust Fund       | Effective interest method | \$610         | (15)                         | \$595                        | N/A                     |
| Total Non-Marketable                 |                           | 610           | (15)                         | 595                          | N/A                     |
| Non-Marketable, Market-Based         | Straight line method      | 39            | -                            | 39                           | 39                      |
| <b>Total Investments, Net</b>        |                           | <b>\$ 649</b> | <b>(\$15)</b>                | <b>\$ 634</b>                | <b>N/A</b>              |

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (Oil Spill Liability Trust Fund and General Gift Fund) for USCG. The cash receipts collected from the public for an earmarked fund are deposited in the Treasury, which uses the cash for general Federal Government purposes. Treasury securities are issued to USCG as evidence of its receipts. Treasury securities associated with earmarked are an

asset to USCG and a liability to the Treasury. Because Treasury and DHS are both parts of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, these funds do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide USCG with authority to draw upon the Treasury to make future benefit payments or other expenditures. When the USCG requires redemption of these securities to make expenditures, the Federal Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Federal Government finances all other expenditures.

The change in accounting method for SFRBTF, as described in Note 36, resulted in the net investments line on the September 30, 2007 Balance Sheet to increase by approximately \$1.8 billion over the September 30, 2006 investments balance.

## 6. Accounts Receivable, Net

Accounts Receivable, net, at September 30 consisted of the following (in millions):

|                                 | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---------------------------------|---------------------|-----------------------------------|
| Intragovernmental               | \$278               | \$247                             |
| With the Public:                |                     |                                   |
| Accounts Receivable             | 1,229               | 1,639                             |
| Allowance for Doubtful Accounts | (469)               | (458)                             |
|                                 | <b>760</b>          | <b>1,181</b>                      |
| <b>Accounts Receivable, Net</b> | <b>\$1,038</b>      | <b>\$1,428</b>                    |

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services and user fees. The decrease in accounts receivable with the public is primarily caused by an increase in payments to TSA received for Aviation Security Infrastructure Fees due from airline companies.

## 7. Taxes, Duties, and Trade Receivables, Net

Taxes, Duties, and Trade Receivables consisted of the following (in millions):

As of September 30, 2007 (Unaudited):

| Receivables Category                                 | Gross Receivables | Allowance        | Total Net Receivables |
|--|-------------------|------------------|-----------------------|
| Duties   | \$1,694           | \$(116)          | \$1,578               |
| Excise Taxes   | 127               | (6)              | 121                   |
| User Fees  | 132               | (5)              | 127                   |
| Fines/Penalties                                      | 1,260             | (1,185)          | 75                    |
| Anti-Dumping/Countervailing Duties                   | 314               | (278)            | 36                    |
| <b>Total Tax, Duties, and Trade Receivables, Net</b> | <b>\$3,527</b>    | <b>\$(1,590)</b> | <b>\$1,937</b>        |

As of September 30, 2006 (Unaudited) (Restated):

| Receivables Category                                 | Gross Receivables | Allowance        | Total Net Receivables |
|--|-------------------|------------------|-----------------------|
| Duties   | \$1,601           | \$(118)          | \$1,483               |
| Excise Taxes   | 99                | (6)              | 93                    |
| User Fees  | 120               | (13)             | 107                   |
| Fines/Penalties                                      | 1,243             | (1,187)          | 56                    |
| Anti-Dumping/Countervailing Duties                   | 259               | (243)            | 16                    |
| <b>Total Tax, Duties, and Trade Receivables, Net</b> | <b>\$3,322</b>    | <b>\$(1,567)</b> | <b>\$1,755</b>        |

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance on fines and penalties of approximately 94 percent (96 percent at September 30, 2006) of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivables are non-entity assets for which there is an offsetting liability due to the Treasury General Fund.

## 8. Direct Loans, Net

DHS's loan program consists of two types of direct loans, both administered by FEMA: (1) State Share Loans: FEMA may lend or advance to a state or an eligible applicant the portion of assistance for which the applicant is responsible under cost-sharing provisions of the Stafford Act. For 1992 and beyond, the State Share Loans are obligated from the Disaster Assistance Direct

Loan Financing Account; and (2) Community Disaster Loans (CDLs): Loans may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster, and have demonstrated a need for financial assistance in order to perform their municipal operating functions. The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred, with the exception of Hurricanes Katrina/Rita Special CDL. The rates for Katrina/Rita Special CDL are less than the Treasury rate and cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, in accordance with recent Stafford Act amendments (P.L. 109-88), CDLs may exceed \$5 million and shall not be canceled. However, P.L. 110-28 amended the *Community Disaster Loan Act of 2005* (P.L. 109-88) by striking “Provided further, that notwithstanding section 471(c)(1) of the *Stafford Act*, such loans may not be cancelled.” This resulted in a total modification cost of \$327 million for the 2006 Cohort. Of this amount \$207 million was transferred to the Financing account to repay funds borrowed from Treasury. The balance remains in the Programming account to cover costs of undisturbed loans for the 2006 Cohort.

Loans totaling \$162 million and \$629 million have been disbursed to eligible borrowers as of September 30, 2007 and 2006, respectively. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

**A. Summary of Direct Loans to Non-Federal Borrowers at September 30 (in millions):**

|                                 | 2007<br>(Unaudited)   | 2006<br>(Unaudited) (Restated) |
|---------------------------------|-----------------------|--------------------------------|
|                                 | Loans Receivable, Net | Loans Receivable, Net          |
| <b>Community Disaster Loans</b> | <b>\$ -</b>           | <b>\$161</b>                   |

An analysis of loans receivable and the nature and amounts of the subsidy and administrative costs associated with the direct loans is provided in the following sections.

**B. Direct Loans Obligated After FY 1991 (in millions):**

| At September 30, 2007<br>(Unaudited):            | Loans<br>Receivable,<br>Gross | Interest<br>Receivable | Allowance for<br>Subsidy Cost<br>(Present Value) | Value of Assets<br>Related to<br>Direct Loans |
|--|-------------------------------|------------------------|--|---|
| <b>Community Disaster Loans</b>                  | <b>\$792</b>                  | <b>\$30</b>            | <b>\$(822)</b>                                   | <b>\$ -</b>                                   |
| At September 30, 2006<br>(Unaudited) (Restated): | Loans<br>Receivable,<br>Gross | Interest<br>Receivable | Allowance for<br>Subsidy Cost<br>(Present Value) | Value of Assets<br>Related to<br>Direct Loans |
| <b>Community Disaster Loans</b>                  | <b>\$631</b>                  | <b>\$9</b>             | <b>\$(479)</b>                                   | <b>\$161</b>                                  |

**C. Total Amount of Direct Loans Disbursed, Post-1991 (in millions):**

|                          | 2007<br>(Unaudited) | 2006<br>(Unaudited) |
|--------------------------|---------------------|---------------------|
| Community Disaster Loans | <b>\$161</b>        | <b>\$629</b>        |

**D. Subsidy Expense for Direct Loans by Program and Component (in millions):****Subsidy Expense for New Direct Loans Disbursed as of September 30 (in millions):**

|                             | Interest<br>Differential | Defaults and<br>Other | Total |
|-----------------------------|--------------------------|-----------------------|-------|
| Community Disaster Loans    |                          |                       |       |
| 2007 (Unaudited)            | \$28                     | \$93                  | \$121 |
| 2006 (Unaudited) (Restated) | \$109                    | \$362                 | \$471 |

For the Community Disaster Loan Program there were no re-estimates or modifications to the subsidy expense.

**Total Direct Loan Subsidy Expense**

|                          | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--------------------------|---------------------|-----------------------------------|
| Community Disaster Loans | <b>\$329</b>        | <b>\$471</b>                      |

**E. Direct Loan Subsidy Rates at September 30 (in millions):**

The direct loan subsidy rates, by program, are as follows:

|                       | 2007<br>(Unaudited)            |                         | 2006<br>(Unaudited) (Restated) |                      |
|-----------------------|--------------------------------|-------------------------|--------------------------------|----------------------|
|                       | Community<br>Disaster<br>Loans | State<br>Share<br>Loans | Community<br>Disaster<br>Loans | State Share<br>Loans |
| Interest Subsidy Cost | 4.9%                           | 0.82%                   | 17.4 %                         | (0.55) %             |
| Default Costs         | - %                            | - %                     | 57.6 %                         | - %                  |
| Other                 | 88.5%                          | 0.36%                   | - %                            | 0.36 %               |

**F. Schedule for Reconciling Subsidy Cost Allowance Balances at September 30 (in millions):**

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Beginning Balance of the Subsidy cost allowance   | \$479.2             | \$3.2                             |
| Add subsidy expense for direct loans disbursed during the reporting years by component: |                     |                                   |
| (a) Interest rate differential costs  | 28.2                | 109.3                             |
| (b) Other subsidy costs   | 93.3                | 362.1                             |
| Adjustments:  |                     |                                   |
| (a) Loans written off   | (1)                 | -                                 |
| (b) Subsidy allowance amortization  | 15                  | 4.6                               |
| (c) Other   | 207.2               | -                                 |
| Ending balance of the subsidy cost allowance before reestimates                         | 821.9               | 479.2                             |
| Add subsidy reestimate by component   |                     |                                   |
| (a) Technical/default reestimate  | .4                  | -                                 |
| <b>Ending balance of the subsidy cost allowance</b>                                     | <b>\$822.3</b>      | <b>\$479.2</b>                    |

The amount of loans written off as of September 30, 2007 were \$1 million. No write-offs were reported as of September 30, 2006.

**G. Administrative Expenses at September 30 (in millions):**

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Community Disaster and State Share Loans | <b>\$ .5</b>        | <b>\$1.6</b>                      |

## 9. Inventory and Related Property, Net

Inventory and Related Property, net at September 30 consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Operating Materials and Supplies (OM&S)          |                     |                                   |
| Items Held for Use                               | \$302               | \$337                             |
| Items Held for Future Use                        | 30                  | 28                                |
| Excess, Obsolete and Unserviceable Items         | 149                 | 75                                |
| Less: Allowance for Losses                       | (149)               | (75)                              |
| Total OM&S, Net                                  | <b>332</b>          | <b>365</b>                        |
| Inventory  |                     |                                   |
| Inventory Purchased for Resale                   | 61                  | 69                                |
| Less: Allowance for Losses                       | (4)                 | (3)                               |
| Total Inventory, Net                             | <b>57</b>           | <b>66</b>                         |
| Stockpile Materials Held in Reserve              | <b>243</b>          | <b>246</b>                        |
| <b>Total Inventory and Related Property, Net</b> | <b>\$632</b>        | <b>\$677</b>                      |



## 10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and activity for fiscal years 2007 and 2006 are as follows:

| Seizure Activity                                      |                   |              |            |                 |             |                |
|---|-------------------|--------------|------------|-----------------|-------------|----------------|
| Fiscal Year Ended September 30, 2007 (Unaudited)      |                   |              |            |                 |             |                |
| Seized Property Category:                             | Beginning Balance | New Seizures | Remissions | New Forfeitures | Adjustments | Ending Balance |
| Illegal Drugs (in kilograms):                         |                   |              |            |                 |             |                |
| Cannabis (marijuana)                                  | 737               | 774,841      | -          | (772,729)       | 405         | 3,254          |
| Cocaine   | 353               | 22,985       | -          | (23,075)        | (77)        | 186            |
| Heroin  | 20                | 5,459        | -          | (5,463)         | 4           | 20             |
| Ecstasy   | -                 | 1,426        | -          | (1,393)         | -           | 33             |
| Steroids  | -                 | 514          | (65)       | (305)           | (8)         | 136            |
| Firearms and Explosives (in number of items)          | 864               | 1,970        | (886)      | (675)           | (143)       | 1,130          |
| Counterfeit Currency (US/Foreign, in number of items) | 4,227,431         | 1,325,661    | -          | -               | (1,554,722) | 3,998,370      |
| Pornography (in number of items)                      | 101               | 173          | (3)        | (140)           | (55)        | 76             |

| <b>Forfeiture Activity</b>                       |                   |                 |           |           |             |                |
|--|-------------------|-----------------|-----------|-----------|-------------|----------------|
| Fiscal Year Ended September 30, 2007 (Unaudited) |                   |                 |           |           |             |                |
| Forfeited Property Category:                     | Beginning Balance | New Forfeitures | Transfers | Destroyed | Adjustments | Ending Balance |
| Illegal Drugs (in kilograms):                    |                   |                 |           |           |             |                |
| Cannabis (marijuana)                             | 97,304            | 772,729         | (234,858) | (459,151) | (3,629)     | 172,395        |
| Cocaine  | 19,584            | 23,075          | (156)     | (20,545)  | (394)       | 21,564         |
| Heroin   | 2,221             | 5,463           | (4)       | (1,045)   | (43)        | 6,592          |
| Ecstasy  | -                 | 1,393           | (9)       | (1,060)   | 1,543       | 1,867          |
| Steroids   | -                 | 305             | -         | (314)     | 22          | 13             |
| Firearms and Explosives (in number of items)     | 253               | 675             | (607)     | (2)       | 29          | 348            |
| Pornography (in number of items)                 | 32                | 140             | (1)       | (195)     | 53          | 29             |

| <b>Seizure Activity</b>                                     |                   |                 |            |                 |             |                |
|---|-------------------|-----------------|------------|-----------------|-------------|----------------|
| Fiscal Year Ended September 30, 2006 (Unaudited) (Restated) |                   |                 |            |                 |             |                |
| Seized Property Category:                                   | Beginning Balance | New Seizures    | Remissions | New Forfeitures | Adjustments | Ending Balance |
| Illegal Drugs (in kilograms):                               |                   |                 |            |                 |             |                |
| Cannabis (marijuana)  | 502               | 439,748         | -          | (439,597)       | 84          | 737            |
| Cocaine   | 162               | 28,513          | -          | (28,289)        | (33)        | 353            |
| Heroin  | 26                | 1,345           | -          | (1,345)         | (6)         | 20             |
| Firearms and Explosives (in number of items)                | 2,021             | 1,362           | (936)      | (1,521)         | (62)        | 864            |
| Counterfeit Currency (US/Foreign, in number of items)       | 3,364,060         | 1,424,320       | -          | -               | (560,949)   | 4,227,431      |
| Pornography (in number of items)                            | 141               | 158             | -          | (138)           | (60)        | 101            |
| <b>Forfeiture Activity</b>                                  |                   |                 |            |                 |             |                |
| Fiscal Year Ended September 30, 2006 (Unaudited) (Restated) |                   |                 |            |                 |             |                |
| Forfeited Property Category                                 | Beginning Balance | New Forfeitures | Transfers  | Destroyed       | Adjustments | Ending Balance |
| Illegal Drugs (in kilograms):                               |                   |                 |            |                 |             |                |
| Cannabis (marijuana)  | 92,834            | 439,597         | (3,167)    | (362,988)       | (68,972)    | 97,304         |
| Cocaine   | 21,513            | 28,289          | (7)        | (29,663)        | (548)       | 19,584         |
| Heroin  | 2,104             | 1,345           | (1)        | (1,242)         | 15          | 2,221          |
| Firearms and Explosives (in number of items)                | 276               | 1,521           | (1,551)    | (4)             | 11          | 253            |
| Pornography (in number of items)                            | 39                | 138             | -          | (178)           | 33          | 32             |

This schedule is presented for material prohibited (non-valued) seized and forfeited property only. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the Departments of Treasury or Justice Asset Forfeiture Funds or other Federal agencies. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms and a portion of the weight includes packaging, which often cannot be reasonably separated from the weight of the drugs since the packaging must be

maintained for evidentiary purposes. Firearms, explosives, and pornography are presented in number of items, and counterfeit currency is presented in number of bills. The adjustments columns relate to prohibited property adjustments made due to items incorrectly tagged or marked as to seized or forfeited. For seizure activity the adjustments also include destroyed items.

USCG also seizes and takes temporary possession of small boats, equipment, contraband, and other illegal drugs. USCG usually disposes of these properties within three days by transfer to CBP (who transfers non-prohibited seized property to the Treasury Forfeiture Fund), the Drug Enforcement Administration, foreign governments, or by destroying it. Seized property in USCG possession at year-end is not considered material and therefore is not itemized and is not reported in the financial statements of the Department.

CBP will take into custody, without risk or expense, merchandise termed “general order property”, which for various reasons cannot legally enter into the commerce of the United States. CBP’s sole responsibility with general order property is to ensure the property does not enter the Nation’s commerce. If general order property remains in CBP custody for a prescribed period of time, without payment of all estimated duties, storage, and other charges, the property is considered unclaimed and abandoned and may be sold by CBP at public auction, retained by CBP for its official use, or at CBP’s discretion, be transferred to any other Federal, State, or local agency, destroyed, or disposed of otherwise. Auction sales revenue in excess of charges associated with the sale or storage of the item is remitted to the Treasury General Fund. In some cases, CBP incurs charges prior to the sale and funds these costs from entity appropriations. Regulations permit CBP to offset these costs of sale before returning excess amounts to Treasury.

## 11. General Property, Plant, and Equipment, Net

General Property, Plant, and Equipment (PP&E) consisted of the following (in millions):

| As of September 30, 2007<br>(Unaudited):      | Service<br>Life | Gross Cost | Accumulated<br>Depreciation/<br>Amortization | Total<br>Net Book<br>Value |
|---|-----------------|------------|--|----------------------------|
| Land and Land Rights                          | N/A             | \$90       | N/A  | \$90                       |
| Improvements to Land                          | 3-50 yrs        | 114        | 49   | 65                         |
| Construction in Progress                      | N/A             | 4,468      | N/A  | 4,468                      |
| Buildings, Other Structures<br>and Facilities | 2-50 yrs        | 4,147      | 1,993  | 2,154                      |
| Equipment:                                    |                 |            |  |                            |
| ADP Equipment                                 | 3-5 yrs         | 317        | 191  | 126                        |
| Aircraft                                      | 10-35 yrs       | 2,722      | 1,558  | 1,164                      |
| Vessels                                       | 5-65 yrs        | 4,317      | 2,365  | 1,952                      |
| Vehicles                                      | 3-8 yrs         | 573        | 448  | 125                        |
| Other Equipment                               | 2-30 yrs        | 3,834      | 2,409  | 1,425                      |
| Assets Under Capital Lease                    | 2-20 yrs        | 79         | 26   | 53                         |

|  |          |                 |                |                 |
|--|----------|-----------------|----------------|-----------------|
| Leasehold Improvements                                   | 3-50 yrs | 364             | 104            | 260             |
| Internal Use Software                                    | 2-10 yrs | 897             | 714            | 183             |
| Internal Use Software- in Development                    | N/A      | 210             | N/A            | 210             |
| <b>Total General Property, Plant, and Equipment, Net</b> |          | <b>\$22,132</b> | <b>\$9,857</b> | <b>\$12,275</b> |

| As of September 30, 2006<br>(Unaudited) (Restated):      | Service<br>Life | Gross Cost       | Accumulated<br>Depreciation/<br>Amortization | Total<br>Net Book<br>Value |
|--|-----------------|------------------|--|----------------------------|
| Land and Land Rights                                     | N/A             | \$75             | N/A  | \$75                       |
| Improvements to Land                                     | 3-50 yrs        | 64               | 29   | 35                         |
| Construction in Progress                                 | N/A             | 2,899            | N/A  | 2,899                      |
| Buildings, Other Structures and Facilities               | 2-50 yrs        | 3,893            | 1,903  | 1,990                      |
| Equipment:   |                 |                  |  |                            |
| ADP Equipment  | 3-5 yrs         | 349              | 187  | 162                        |
| Aircraft   | 10-35 yrs       | 2,595            | 1,441  | 1,154                      |
| Vessels  | 5-65 yrs        | 4,233            | 2,152  | 2,081                      |
| Vehicles   | 3-8 yrs         | 505              | 382  | 123                        |
| Other Equipment  | 2-30 yrs        | 3,867            | 2,060  | 1,807                      |
| Assets Under Capital Lease                               | 2-20 yrs        | 79               | 23   | 56                         |
| Leasehold Improvements                                   | 3-50 yrs        | 381              | 104  | 277                        |
| Internal Use Software                                    | 2-10 yrs        | 910              | 567  | 343                        |
| Internal Use Software- in Development                    | N/A             | 149              | N/A  | 149                        |
| <b>Total General Property, Plant, and Equipment, Net</b> |                 | <b>\$ 19,999</b> | <b>\$8,848</b>                               | <b>\$11,151</b>            |

## 12. Stewardship Property, Plant, and Equipment

DHS's Stewardship PP&E primarily consists of USCG's Heritage Assets, which are unique due to historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. USCG's Heritage Assets includes sunken craft, historical buildings, structures, artifacts, and art and display models.

USCG does not acquire or retain Heritage buildings and structures without an operational purpose. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the USCG buildings and structures designated as Heritage Assets, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use Heritage Assets. The

remainder is comprised of historical lighthouses, which are no longer in use and awaiting transfer or disposal. CBP also has four multi-use heritage assets located in Puerto Rico and FEMA has one multi-use heritage asset that is used by the U. S. Fire Administration for training in Emmitsburg, Maryland.

### 13. Other Assets

Other Assets at September 30 consisted of the following (in millions):

|                           | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---------------------------|---------------------|-----------------------------------|
| Intragovernmental:        |                     |                                   |
| Advances and Prepayments  | \$2,887             | \$2,913                           |
| Due from Treasury         | 176                 | 411                               |
| Total Intragovernmental   | 3,063               | 3,324                             |
| Public:                   |                     |                                   |
| Advances and Prepayments  | 567                 | 551                               |
| Total Public              | 567                 | 551                               |
| <b>Total Other Assets</b> | <b>\$3,630</b>      | <b>\$3,875</b>                    |

Intragovernmental Advances and Prepayments primarily consist of FEMA's Disaster Relief Fund disaster assistance advances to other Federal agencies (principally the Department of Transportation) tasked with restoration efforts of the New York City region transportation system.

The Department provides advance funds to public grant recipients to incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation.

## 14. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at September 30 consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Intragovernmental:   |                     |                                   |
| Debt (Note 15)   | \$17,786            | \$17,092                          |
| Accrued FECA Liability (Note 18)                                   | 355                 | 323                               |
| Other  | 51                  | 67                                |
| Total Intragovernmental  | 18,192              | 17,482                            |
| Public:  |                     |                                   |
| Federal Employee and Veterans' Benefits:                           |                     |                                   |
| Actuarial FECA Liability (Note 16)                                 | 1,683               | 1,520                             |
| Military Service and Other Retirement Benefits (Note 16)           | 33,227              | 30,758                            |
| Environmental and Disposal Liabilities (Note 17)                   | 254                 | 245                               |
| Other:   |                     |                                   |
| Accrued Payroll and Benefits (Note 18)                             | 874                 | 824                               |
| Insurance Liabilities (Note 20)                                    | 1,508               | 3,557                             |
| Contingent Legal Liabilities (Note 21)                             | 90                  | 24                                |
| Capital Lease Liability (Note 19)                                  | 107                 | 110                               |
| Other  | -                   | -                                 |
| Total Public   | 37,743              | 37,038                            |
| Total Liabilities Not Covered by Budgetary Resources               | 55,935              | 54,520                            |
| Liabilities Covered by Budgetary Resources or<br>Non-Entity Assets | 12,998              | 16,269                            |
| <b>Total Liabilities</b>   | <b>\$68,933</b>     | <b>\$70,789</b>                   |

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required. Budgetary resources are generally provided for unfunded leave when it is used. Unfunded leave is included in accrued payroll and benefits.

Insurance liabilities decreased in FY 2007 due to payments of flood insurance claims, primarily related to Hurricanes Katrina and Rita. The Liabilities Covered by Budgetary Resources or Non-Entity Assets decreased in FY 2007 due to Canadian Softwood lumber refunds disbursed during FY 2007.



## 15. Debt

Debt at September 30 consisted of the following (in millions):

| Fiscal year ended September 30, 2007    | Beginning<br>Balance | Net<br>Borrowing | Ending<br>Balance<br>(Unaudited) |
|---|----------------------|------------------|----------------------------------|
| <b>Other Debt:</b>                      |                      |                  |                                  |
| Debt for the NFIP                       | \$17,239             | \$663            | \$17,902                         |
| Debt for Credit Reform                  | 207                  | 44               | 251                              |
| Total Debt to the Treasury General Fund | \$17,446             | \$707            | \$18,153                         |
| <b>Total Debt</b>                       | <b>\$17,446</b>      | <b>\$707</b>     | <b>\$18,153</b>                  |

| Fiscal year ended September 30, 2006    | Beginning<br>Balance | Net<br>Borrowing | Ending<br>Balance<br>(Unaudited)<br>(Restated) |
|---|----------------------|------------------|--|
| <b>Other Debt:</b>                      |                      |                  |  |
| Debt for the NFIP                       | \$225                | \$17,014         | \$17,239                                       |
| Debt for Credit Reform                  | 1                    | 206              | 207  |
| Total Debt to the Treasury General Fund | \$226                | \$17,220         | \$17,446                                       |
| <b>Total Debt</b>                       | <b>\$226</b>         | <b>\$17,220</b>  | <b>\$17,446</b>                                |

DHS's intragovernmental debt is owed to Treasury's Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance the FEMA's credit reform programs (State Share Loans and Community Disaster Loans). The Net Borrowings in FY 2006 was the result of an increase to FEMA's borrowing authority to satisfy claims as a result of the 2005 hurricane season.

NFIP loans are for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 3.38 percent to 4.88 percent as of September 30, 2007 and from 4.87 percent to 6.69 percent as of September 30, 2006. Simple interest is calculated monthly – offset by an interest rebate, if applicable. The interest rebate is calculated at a rate equal to the weighted average of the interest rates of outstanding loans for the month multiplied by the "positive" daily account fund balance for the month. Interest is paid semi-annually, October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity, but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual reestimate is performed to determine any change from

the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority which is to be approved by OMB. Once these funds are appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2007 and FY 2006 were 4.87 percent and 4.53 percent, respectively.

## 16. Federal Employee and Veterans' Benefits

Accrued liability for military service and other retirement and employment benefits at September 30 consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| USCG Military Retirement and Healthcare Benefits     | \$29,494            | \$27,105                          |
| USCG Post-Employment Military Travel Benefits        | 133                 | 128                               |
| USSS DC Pension Plan Benefits                        | 3,595               | 3,518                             |
| Actuarial FECA Liability                             | 1,683               | 1,520                             |
| Other  | 5                   | 7                                 |
| <b>Total Federal Employee and Veterans' Benefits</b> | <b>\$34,910</b>     | <b>\$32,278</b>                   |

### A. USCG Military Retirement and Healthcare Benefits

The USCG Military Retirement System (MRS or the Plan) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the USCG. The Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions and any plan assets, from the present value of the future cost of benefits. Current period expense is computed using the aggregate entry age normal actuarial cost method.

The components of the MRS expense for the years ended September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Defined Benefit Plan:                     |                     |                                   |
| Normal cost                               | \$653               | \$589                             |
| Interest on the liability                 | 1,417               | 1,376                             |
| Actuarial losses/(gains)                  | 120                 | (239)                             |
| Actuarial Assumption Change               | 721                 | 902                               |
| Plan Amendments                           | 136                 | -                                 |
| <b>Total Defined Benefit Plan Expense</b> | <b>\$3,047</b>      | <b>\$2,628</b>                    |

## Post-retirement Healthcare:

|  |                       |                       |
|--|-----------------------|-----------------------|
| Normal cost                              | \$151                 | \$180                 |
| Interest on the liability                | 287                   | 249                   |
| Other Actuarial (gains)/losses           | (281)                 | 48                    |
| Total Post-retirement Healthcare Expense | <u>157</u>            | <u>477</u>            |
| <b>Total MRS Expense</b>                 | <b><u>\$3,204</u></b> | <b><u>\$3,105</u></b> |

USCG's military service members (both active duty and reservists) participate in the MRS. USCG receives an annual "Retired Pay" appropriation to fund MRS benefits. The retirement system allows voluntary retirement for active members upon credit of at least 20 years of active service at any age. Reserve members may retire after 20 years of creditable service with benefits beginning at age 60. USCG's MRS includes the USCG Military Health Services System (Health Services Plan). The Health Services Plan is a post-retirement medical benefit plan, which covers all active duty and reserve members of the USCG.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible retirees and survivors. Effective October 1, 2002, USCG transferred its liability for the health care of Medicare eligible retirees/survivors to the DOD Medicare-Eligible Retiree Health Care Fund (the Fund), which was established in order to finance the health care benefits for the Medicare-eligible beneficiaries of all DOD and non-DOD uniformed services. DOD is the administrative entity for the DOD Medicare-Eligible Retiree Health Care Fund and in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 5, is required to recognize the liability on the Fund's financial statements. USCG makes annual payments to the Fund for current active duty members. Benefits for USCG members who retired prior to the establishment of the Fund are provided by payments from the Treasury to the Fund. The future cost and liability of the Fund is determined using claim factors and claims cost data developed by the DOD, adjusted for USCG retiree and actual claims experience. USCG uses the current year actual costs to project costs for all future years.

The unfunded accrued liability, presented as a component of the liability for military service and other retirement in the accompanying Balance Sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. Valuation of the plan's liability is based on the actuarial present value of accumulated plan benefits derived from the future payments that are attributable, under the retirement plan's provisions, to a participant's credited service as of the valuation date. Credited service is the years of service from active duty base date (or constructive date in the case of active duty reservists) to date of retirement measured in years and completed months. The present value of future benefits is then converted to an unfunded accrued liability by subtracting the present value of future employer/employee normal contributions. USCG plan participants may retire after 20 years of active service at any age with annual benefits equal to 2.5 percent of retired base pay for each year of credited service up to 75 percent of basic pay. Personnel who became members after August 1, 1986, may elect to receive a \$30,000 lump sum bonus after 15 years of service and reduced benefits prior to age 62. Annual disability is equal to the retired pay base multiplied by the larger of: (1) 2.5 percent times years of service; or (2) percent disability. The benefit cannot be more than 75 percent of retired pay base. If a USCG member is disabled, the member is entitled to disability benefits, assuming the disability is at least

30 percent (under a standard schedule of rating disabilities by Veterans Affairs) and either: (1) the member has one month and one day of service; (2) the disability results from active duty; or (3) the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

The significant actuarial assumptions used to compute the MRS accrued liability are:

- life expectancy is based upon the DOD death mortality table;
- cost of living increases are 3.0 percent annually; and
- annual rate of investment return is 6.0 percent.

## **B. District of Columbia Police and Fireman's Retirement System for U.S. Secret Service Employees**

Special agents and personnel in certain job series hired by USSS before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of protection related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. The USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants, and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, requires the administrative entity (administrator) to report the actuarial liability. However, the USSS adopted the provisions of SFFAS No. 5 because the administrator, the DC Pension Plan, is not a Federal entity and as such the liability for future funding would not otherwise be recorded in the Government-wide consolidated financial statements.

The liability and expense are computed using the aggregate cost method. The primary actuarial assumptions used to determine the liability at September 30, 2007, are:

- life expectancy is based upon the 1994 Uninsured Pension (UP94) tables;
- cost of living increases are 3.5 percent annually;
- rates of salary increases are 3.5 percent annually;
- annual rate of investment return is 7.25 percent; and
- rates of withdrawal for active service by gender and age.

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2007 and 2006, were \$215 million and \$202 million, respectively.

## **C. Actuarial FECA Liability**

The actuarial Federal Employees' Compensation Act (FECA) liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates,

generated from an application of actuarial procedures developed by the DOL, for the future cost of approved compensation cases were approximately \$1.7 billion and \$1.5 billion at September 30, 2007 and 2006, respectively (unaudited).

## **17. Environmental and Disposal Liabilities**

Environmental and Disposal Liabilities at September 30, 2007 and 2006, are \$275 million and \$245 million, respectively (unaudited). The Department is responsible to remediate its sites with environmental contamination, and is party to various administrative proceedings, legal actions, and tort claims which may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, State, or local environmental laws and regulations. The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response, Compensation and Liability Act (P.L. 96-510)* and the *Resource Conservation and Recovery Act (P.L. 94-580)*.

The liabilities are primarily due to lighthouses, light stations, fuel storage tank program, buildings containing asbestos and/or lead based paint, firing ranges, fuels, solvents, industrial chemicals, and other environmental cleanup associated with normal operations of CBP, FLETC, and USCG. For the Plum Island Animal Disease Center, under S&T, potential environmental liabilities may exist in addition to the amounts accrued in the accompanying financial statements that are not presently estimable but could exist due to the facility's age, old building materials used, and other materials associated with the facility's past use as a U.S. Army installation for coastline defense.

Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in inflation, technology, environmental laws and regulations, and plans for disposal.

## 18. Other Liabilities

Other Liabilities at September 30 consisted of the following (in millions):

| <b>Fiscal year ended September 30, 2007</b>                    | <b>Current</b> | <b>Non-Current</b> | <b>(Unaudited)</b> |
|--|----------------|--------------------|--------------------|
| <b>Intragovernmental:</b>                                      |                |                    |                    |
| Accrued FECA Liability   | \$219          | \$136              | \$355              |
| Advances from Others   | 70             | -                  | 70                 |
| Employer Benefits Contributions and Payroll Taxes              | 118            | -                  | 118                |
| Due to the General Fund (Note 2)                               | 2,085          | -                  | 2,085              |
| Other Intragovernmental Liabilities                            | 57             | -                  | 57                 |
| <b>Total Intragovernmental Other Liabilities</b>               | <b>\$2,549</b> | <b>\$136</b>       | <b>\$2,685</b>     |
| <b>Public:</b>   |                |                    |                    |
| Accrued Payroll and Benefits (See B. below)                    | \$1,534        | \$19               | \$1,553            |
| Deferred Revenue and Advances from Others (See B. below)       | 1,682          | 1,045              | 2,727              |
| Unliquidated Antidumping/Countervailing Duties (Notes 2 and 3) | 514            | -                  | 514                |
| Injured Domestic Industries (Notes 2 and 3)                    | 388            | -                  | 388                |
| Insurance Liabilities (Note 20)                                | 513            | 995                | 1,508              |
| Contingent Legal Liabilities (Note 21)                         | 135            | 1                  | 136                |
| Capital Lease Liability (Note 19)                              | 50             | 57                 | 107                |
| Refunds and Drawbacks (Note 2) (See B. below)                  | 131            | -                  | 131                |
| Other Liabilities  | 777            | -                  | 777                |
| <b>Total Other Liabilities with the Public</b>                 | <b>\$5,724</b> | <b>\$2,117</b>     | <b>\$7,841</b>     |
| <b>Total Other Liabilities</b>                                 | <b>\$8,273</b> | <b>\$2,253</b>     | <b>\$10,526</b>    |

| <b>Fiscal year ended September 30, 2006</b>                    | <b>Current</b>  | <b>Non-Current</b> | <b>Total<br/>(Unaudited)<br/>(Restated)</b> |
|--|-----------------|--------------------|---|
| <b>Intragovernmental:</b>                                      |                 |                    |   |
| Accrued FECA Liability   | \$154           | \$185              | \$339                                       |
| Advances from Others   | 22              | -                  | 22  |
| Employer Benefits Contributions and Payroll Taxes              | 150             | 3                  | 153   |
| Due to the General Fund (Note 2)                               | 1,809           | -                  | 1,809                                       |
| Other Intragovernmental Liabilities                            | 4               | 8                  | 12  |
| <b>Total Intragovernmental Other Liabilities</b>               | <b>\$2,139</b>  | <b>\$196</b>       | <b>\$2,335</b>                              |
| <b>Public:</b>   |                 |                    |   |
| Accrued Payroll and Benefits (See B. below)                    | \$1,173         | \$189              | \$1,362                                     |
| Deferred Revenue and Advances from Others (See B. below)       | 1,200           | 988                | 2,188                                       |
| Unliquidated Antidumping/Countervailing Duties (Notes 2 and 3) | 34              | -                  | 34  |
| Injured Domestic Industries (Notes 2 and 3)                    | 476             | -                  | 476   |
| Insurance Liabilities (Note 20)                                | 1,177           | 2,390              | 3,567                                       |
| Contingent Legal Liabilities (Note 21)                         | -               | 71                 | 71  |
| Capital Lease Liability (Note 19)                              | 16              | 106                | 122   |
| Refunds and Drawbacks (Note 2) (See B. below)                  | 5,593           | -                  | 5,593                                       |
| Other Liabilities  | 469             | 67                 | 536   |
| <b>Total Other Liabilities with the Public</b>                 | <b>\$10,138</b> | <b>\$3,811</b>     | <b>\$13,949</b>                             |
| <b>Total Other Liabilities</b>                                 | <b>\$12,277</b> | <b>\$4,007</b>     | <b>\$16,284</b>                             |

## A. Intragovernmental Other Liabilities

**Workers' Compensation.** Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL on payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers compensation expense was \$154 million and \$164 million, respectively (unaudited), for the fiscal years ended September 30, 2007 and 2006.



**Due to the General Fund.** Amounts due to the Treasury General Fund represent duty, tax, and fees collected by CBP to be remitted to various General Fund accounts maintained by Treasury.

## B. Other Liabilities with the Public

**Accrued Payroll and Benefits.** Accrued Payroll and Benefits at September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Accrued Funded Payroll and Benefits       | \$656               | \$524                             |
| Accrued Unfunded Leave                    | 852                 | 767                               |
| Unfunded Employment Related Liabilities   | 22                  | 57                                |
| Other                                     | 23                  | 14                                |
| <b>Total Accrued Payroll and Benefits</b> | <b>\$1,553</b>      | <b>\$1,362</b>                    |

**Deferred Revenue and Advances from Others.** Deferred Revenue and Advances From Others for the periods ended September 30 consisted of the following (in millions):

|                               | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|-------------------------------|---------------------|-----------------------------------|
| USCIS Application Fees        | \$1,132             | \$702                             |
| FEMA Unexpired NFIP premium   | 1,582               | 1,473                             |
| Advances from Others          | 13                  | 13                                |
| <b>Total Deferred Revenue</b> | <b>\$2,727</b>      | <b>\$2,188</b>                    |

USCIS requires payments of fees for applications or petitions for immigration and naturalization benefits at the time of filing. FEMA's deferred revenue relates to unearned NFIP premiums that are recognized over the term of the period of insurance coverage.

**Unliquidated Antidumping and Countervailing Duties and Injured Domestic Industries.** The *Continued Dumping and Subsidy Offset Act of 2000, P.L. 106-387, Title X*, enacted in FY 2001 calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. economy at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. The duties will eventually be distributed, pursuant to rulings by the Department of Commerce.

**Refunds and Drawbacks.** The liability for refunds and drawbacks for the fiscal years ended September 30 consisted of the following (in millions):

|   | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|---|---------------------|-----------------------------------|
| Canadian Softwood Lumber Duties and<br>Accrued Interest | \$ -                | \$5,504                           |
| Other Refunds and Drawbacks                             | 131                 | 89                                |
| <b>Total Refunds and Drawbacks</b>                      | <b>\$131</b>        | <b>\$ 5,593</b>                   |

CBP collected duties on the import of Canadian Softwood lumber which were included in non-entity fund balance with Treasury during FY 2006. During FY 2006, an agreement was reached related to the litigation for duties related to the import of Canadian Softwood lumber. As a result of this agreement, the Canadian Softwood lumber duties previously collected and accrued interest was refunded during FY 2007, which accounts for the decrease to the Refunds and Drawbacks balance.

**Other Liabilities.** Other public liabilities consist primarily of NFIP payable to insurance companies and the liability for deposit and suspense funds.

## 19. Leases

### A. Operating Leases

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. The majority of office space occupied by the Department is either owned by the Federal Government or is leased by GSA from commercial sources. The Department is not committed to continue paying rent to GSA beyond the period occupied, providing that proper advance notice to GSA is made and unless the space occupied is designated as unique to Department operations. However, it is expected the Department will continue to occupy and lease office space from GSA in future years and lease charges will be adjusted annually to reflect operating costs incurred by GSA.

As of September 30, 2007, estimated future minimum lease commitments under operating leases for equipment and GSA controlled leases were as follows (in millions) (unaudited):

|  | GSA            | Non-GSA      | Total          |
|--|----------------|--------------|----------------|
| FY 2008  | \$906          | \$115        | \$1,021        |
| FY 2009  | 935            | 113          | 1,048          |
| FY 2010  | 956            | 115          | 1,071          |
| FY 2011  | 985            | 118          | 1,103          |
| FY 2012  | 1,018          | 123          | 1,141          |
| After FY 2012                                  | 2,830          | 356          | 3,186          |
| <b>Total Future Minimum<br/>Lease Payments</b> | <b>\$7,630</b> | <b>\$940</b> | <b>\$8,570</b> |

The estimated future lease payments for GSA controlled leases are based on payments made during the year ended September 30, 2007.

## B. Capital Leases

The Department maintains capital leases for buildings and commercial software license agreements. The liabilities associated with capital leases and software license agreements are presented as other liabilities in the accompanying financial statements based upon the present value of the future minimum lease payments.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements may be funded from future sources.

As of September 30, 2007, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

|  | Total        |
|--|--------------|
| FY 2008                                    | \$24         |
| FY 2009                                    | 24           |
| FY 2010                                    | 24           |
| FY 2011                                    | 6            |
| FY 2012                                    | 6            |
| After FY 2012                              | 64           |
| <b>Total Future Minimum Lease Payments</b> | <b>148</b>   |
| Less: Imputed interest and Executory costs | (41)         |
| <b>Total Capital Lease Liability</b>       | <b>\$107</b> |

## 20. Insurance Liabilities

Insurance liabilities for the periods ended September 30, 2007 and 2006 were \$1,508 million and \$3,567 million, respectively (unaudited), and consist of primarily NFIP insurance liabilities. Insurance liabilities decreased in FY 2007 due to payments of flood insurance claims, primarily related to Hurricanes Katrina and Rita.

The insurance liability for unpaid losses and related loss adjustment expenses and amounts paid for the year ended September 30 consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Beginning Balance                                | \$3,567             | \$23,416                          |
| Change in incurred losses                        | (926)               | (2,281)                           |
| Less: Amounts paid during current period         | (1,133)             | (17,568)                          |
| <b>Total Insurance Liability at September 30</b> | <b>\$1,508</b>      | <b>\$3,567</b>                    |

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are continually reviewed, and adjustments, reflected in current operations, are made as deemed necessary.

NFIP premium rates are generally established for actuarially rated policies with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding.

Notwithstanding the foregoing, subsidized rates have historically been charged on a countrywide basis for certain classifications of insured. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year. The subsidized rates do not include a provision for losses from catastrophic flooding. Subsidized rates are used to provide affordable insurance on construction or substantial improvements started on or before December 31, 1974, or before the effective date of the initial Flood Insurance Rate Map (i.e., an official map of a community on which NFIP has delineated both the special hazard areas and the non-subsidized premium zones applicable to the community).

## 21. Commitments and Contingent Liabilities

### A. Legal Contingent Liabilities

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation related claims at September 30, 2007, was \$136 million, of which \$46 million was funded. The range of probable and estimable litigation is \$136 million to \$232 million. Asserted and pending legal claims for which loss is reasonably possible is estimated to range from \$124 million to \$915 million at September 30, 2007.

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation related claims at September 30, 2006, was \$71 million, of which \$47 million was funded. At September 30, 2006, the range of probable and estimable litigation was \$71 million to \$100 million. Asserted and pending legal claims for which loss is reasonably possible was estimated to range from \$68 million to \$2.7 billion, at September 30, 2006.

The nature of probable and reasonably possible claims is litigation related to the *Federal Tort Claims Act (P.L. 79-601)*, Oil Spill Liability Trust Fund, and various customs laws and regulations. The Department is subject to various other legal proceedings and claims. In management's opinion, the ultimate resolution of other actions will not materially affect the Department's financial position or net costs. Contingent liabilities considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

DHS management and general legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing contingencies related to legal proceedings that are pending against DHS, or unasserted claims that may result in such proceedings, general legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amounts of relief sought or expected to be brought therein.

If the assessment of the loss contingency indicates that it is probable that a material liability has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the financial statements regardless of the source of funding used to pay the liability. If the assessment indicates that a potentially material contingent liability is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, is disclosed.

## **B. Duty and Trade Refunds**

There are various trade related matters that fall under the jurisdiction of other Federal agencies, such as the Department of Commerce, which may result in refunds of duties, taxes and fees collected by CBP. Until a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount, if any, for trade related refunds under jurisdiction of other Federal agencies in addition to the amount accrued on the accompanying financial statements. All known refunds as of September 30, 2007, and 2006, have been recorded.

## **C. Loaned Aircraft and Equipment**

The Department is generally liable to DOD for damage or loss to aircraft on loan to CBP. As of September 30, 2007 and September 30, 2006, CBP had 16 aircraft loaned from DOD with an acquisition value of \$94 million (unaudited).

## **D. Other Contractual Arrangements**

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. As of September 30, 2007, DHS estimates \$47 million (unaudited) in obligations related to cancelled appropriations for which the Department has a contractual obligation for payment as well as an estimated \$14 million (unaudited) for contractual

arrangements which may require future funding. As of September 30, 2006, DHS estimated \$67 million (unaudited) in obligations related to cancelled appropriations for which the Department has a contractual obligation for payment as well as an estimated \$41 million (unaudited) for contractual arrangements which may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with eight major airports in which TSA may reimburse the airports for 75 percent (estimated total of \$957 million) of the cost to modify the facilities for security purposes. These Letters of Intent would not obligate TSA until funds have been appropriated and obligated. TSA has received appropriations of \$162 million (unaudited) in FY 2007 and \$240 million (unaudited) in FY 2006 under this program, which is available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2007, TSA has received invoices or documentation for costs incurred totaling \$572 million (unaudited) related to these agreements.

## 22. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SSFAS No. 27 defines the following three criteria for determining an earmarked fund: (1) A statute committing the Federal Government to use specifically identified revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; (2) Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and (3) A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the Federal Government's general revenues.

Earmarked Funds containing no eliminations within the earmarked funds consisted of the following (in millions) (unaudited):

|   | Customs<br>User Fees | Sport Fish<br>Restoration<br>Boating Trust<br>Fund | Immigration<br>Examination<br>Fees | National<br>Flood<br>Insurance<br>Program | All Other<br>Earmarked<br>Funds | Total<br>Earmarked<br>Funds |
|---|----------------------|--|------------------------------------|---|---------------------------------|-----------------------------|
| <b>Balance Sheet as of September 30, 2007</b> |                      |  |                                    |   |                                 |                             |
| <b>ASSETS</b>                                 |                      |  |                                    |   |                                 |                             |
| Fund Balance with                             |                      |  |                                    |   |                                 |                             |
| Treasury                                      | \$730                | \$8  | \$1,245                            | \$656                                     | \$1,061                         | \$3,700                     |
| Investments, Net                              | -                    | 1,845  | -                                  | -   | 933                             | 2,778                       |
| Taxes Receivables                             | 69                   | -  | -                                  | -   | -                               | 69                          |
| Other   | 76                   | 19   | 267                                | 497                                       | 247                             | 1,106                       |
| <b>Total Assets</b>                           | <b>\$875</b>         | <b>\$1,872</b>                                     | <b>\$1,512</b>                     | <b>1,153</b>                              | <b>\$2,241</b>                  | <b>\$7,653</b>              |
| <b>LIABILITIES</b>                            |                      |  |                                    |   |                                 |                             |
| Other Liabilities                             | \$87                 | \$1,101  | \$1,516                            | \$21,054                                  | \$131                           | \$23,889                    |
| <b>Total Liabilities</b>                      | <b>\$87</b>          | <b>\$1,101</b>                                     | <b>\$1,516</b>                     | <b>\$21,054</b>                           | <b>\$131</b>                    | <b>\$23,889</b>             |

|   | Customs<br>User Fees | Sport Fish<br>Restoration<br>Boating Trust<br>Fund | Immigration<br>Examination<br>Fees | National<br>Flood<br>Insurance<br>Program | All Other<br>Earmarked<br>Funds | Total<br>Earmarked<br>Funds |
|---|----------------------|--|------------------------------------|---|---------------------------------|-----------------------------|
| <b>NET POSITION</b>                           |                      |  |                                    |   |                                 |                             |
| Cumulative Results of<br>Operations           | \$788                | \$771  | \$(4)                              | \$(19,901)                                | \$2,110                         | \$(16,236)                  |
| <b>Total Liabilities and Net<br/>Position</b> | <b>\$875</b>         | <b>\$1,872</b>                                     | <b>\$1,512</b>                     | <b>\$1,153</b>                            | <b>\$2,241</b>                  | <b>\$7,653</b>              |

**Statement of Net Cost for the Year Ended September 30, 2007**

|                               |              |               |             |                  |              |                |
|-------------------------------|--------------|---------------|-------------|------------------|--------------|----------------|
| Gross Program Costs           | \$369        | \$ -          | \$1,681     | \$799            | \$1,163      | \$4,012        |
| Less: Earned Revenues         | -            | (76)          | (1,669)     | (2,622)          | (426)        | (4,793)        |
| <b>Net Cost of Operations</b> | <b>\$369</b> | <b>\$(76)</b> | <b>\$12</b> | <b>\$(1,823)</b> | <b>\$737</b> | <b>\$(781)</b> |

**Statement of Changes in Net Position for the Year Ended September 30, 2007**

|   |              |              |              |                   |                |                   |
|---|--------------|--------------|--------------|-------------------|----------------|-------------------|
| <b>Net Position Beginning<br/>of Period</b>         | \$798        | \$-          | \$8          | \$(21,725)        | \$1,582        | \$(19,337)        |
| Adjustment to the<br>Beginning Balance (Note<br>36) | -            | 693          | -            | -                 | -              | 693               |
| Net Cost of Operations                              | (369)        | 76           | (12)         | 1,823             | (737)          | 781               |
| Non-exchange Revenue                                | 1,808        | 628          | -            | -                 | 1,167          | 3,603             |
| Other   | (1,450)      | (626)        | -            | 1                 | 99             | (1,976)           |
| Change in Net Position                              | (11)         | 78           | (12)         | 1,824             | 529            | 2,408             |
| <b>Net Position, End of<br/>Period</b>              | <b>\$787</b> | <b>\$771</b> | <b>\$(4)</b> | <b>\$(19,901)</b> | <b>\$2,111</b> | <b>\$(16,236)</b> |

| Customs<br>User Fees | Immigration<br>Examination<br>Fees | National<br>Flood<br>Insurance<br>Program | All Other<br>Earmarked<br>Funds | Total<br>Earmarked<br>Funds |
|----------------------|------------------------------------|---|---------------------------------|-----------------------------|
|----------------------|------------------------------------|---|---------------------------------|-----------------------------|

**Balance Sheet as of September 30, 2006 (Restated)****ASSETS**

|                            |              |              |              |                |                |
|----------------------------|--------------|--------------|--------------|----------------|----------------|
| Fund Balance with Treasury | \$761        | \$819        | \$138        | \$815          | \$ 2,533       |
| Investments, Net           | -            | -            | -            | 634            | 634            |
| Taxes Receivables          | 61           | -            | -            | -              | 61             |
| Other                      | 72           | 29           | 507          | 220            | 828            |
| <b>Total Assets</b>        | <b>\$894</b> | <b>\$848</b> | <b>\$645</b> | <b>\$1,669</b> | <b>\$4,056</b> |

**LIABILITIES**

|                          |             |              |                 |             |                 |
|--------------------------|-------------|--------------|-----------------|-------------|-----------------|
| Other Liabilities        | \$96        | \$840        | \$22,370        | \$87        | \$23,393        |
| <b>Total Liabilities</b> | <b>\$96</b> | <b>\$840</b> | <b>\$22,370</b> | <b>\$87</b> | <b>\$23,393</b> |

|   | <b>Customs<br/>User Fees</b> | <b>Immigration<br/>Examination<br/>Fees</b> | <b>National<br/>Flood<br/>Insurance<br/>Program</b> | <b>All Other<br/>Earmarked<br/>Funds</b> | <b>Total<br/>Earmarked<br/>Funds</b> |
|---|------------------------------|---|---|--|--------------------------------------|
| <b>NET POSITION</b> (Restated)                |                              |   |   |  |                                      |
| Cumulative Results of<br>Operations           | \$798                        | \$8   | \$(21,725)  | \$1,582                                  | \$(19,337)                           |
| <b>Total Liabilities and Net<br/>Position</b> | <b>\$894</b>                 | <b>\$848</b>                                | <b>\$645</b>  | <b>\$1,669</b>                           | <b>\$4,056</b>                       |

**Statement of Net Cost for the Year Ended September 30, 2006 (Restated)**

|                               |              |                |                  |                |                  |
|-------------------------------|--------------|----------------|------------------|----------------|------------------|
| Gross Program Costs           | \$ -         | \$1,590        | \$(716)          | \$1,459        | \$2,333          |
| Less: Earned Revenues         | (1)          | (1,721)        | (2,321)          | (376)          | (4,419)          |
| <b>Net Cost of Operations</b> | <b>\$(1)</b> | <b>\$(131)</b> | <b>\$(3,037)</b> | <b>\$1,083</b> | <b>\$(2,086)</b> |

**Statement of Changes in Net Position for the Year Ended September 30, 2006 (Restated)**

|   |              |            |                   |                |                   |
|---|--------------|------------|-------------------|----------------|-------------------|
| <b>Net Position Beginning of<br/>Period</b> | \$797        | \$(123)    | \$(24,764)        | \$1,375        | \$(22,715)        |
| Net Cost of Operations                      | 1            | 131        | 3,037             | (1,083)        | 2,086             |
| Non-exchange Revenue                        | -            | -          | -                 | 2,516          | 2,516             |
| Other                                       | -            | -          | 2                 | (1,226)        | (1,224)           |
| Change in Net Position                      | 1            | 131        | 3,039             | 207            | 3,378             |
| <b>Net Position, End of Period</b>          | <b>\$798</b> | <b>\$8</b> | <b>\$(21,725)</b> | <b>\$1,582</b> | <b>\$(19,337)</b> |

**Customs User Fees**

In April 1986, the President signed the *Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)*, which authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category, contained in tax reform legislation, for processing barges and bulk carriers for Canada and Mexico, was added later that year. The collection of COBRA fees for CBP services began on July 7, 1986.

In addition to the collection of user fees, other changes in CBP procedures were enacted due to the COBRA statute. Most importantly, provisions were included for providing non-reimbursable inspectional overtime services and paying for excess pre-clearance costs from COBRA user fee collections.

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available, after overtime and excess pre-clearance costs are satisfied.



Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected. This legislation took effect on October 1, 1990.

19 USC Section 58c contains the fees for certain customs services. The authority to use these funds is contained in the annual DHS appropriations act.

Access to COBRA surplus funds provides CBP with additional resources to assist in the accomplishment of CBP's mission. Increased staffing and equipment have enhanced the manager's flexibility in dealing with the ever-increasing demands of the trade and travel communities.

### **Sport Fish Restoration Boating Trust Fund**

The SFRBTF, previously known as the Aquatic Resources Trust Fund (ARTF), was created by Section 1016 of the *Deficit Reduction Act of 1984 (P.L. 98-369)*. Two funds were created under this act, the Boat Safety Account and the Sport Fish Restoration Account. The SFRBTF has been the source of budget authority for the Boat Safety program for many years through the transfer of appropriated funds. The SFRBTF is a Treasury-managed fund and provides funding to states and other entities to promote boat safety and conservation of U.S. recreational waters.

This fund receives revenues transferred from custodial activities of the Treasury which are deposited in a Treasury account. The revenues are derived from a number of sources including motor boat fuel tax, excise taxes on sport fishing equipment, and import duties on fishing tackle and yachts. Three agencies share in the available portion of the revenue, the Fish & Wildlife Service in the Department of Interior (DOI) (14X8151), the U.S. Army Corps of Engineers (COE) (96X8333), and USCG (70X8149).

The most recent reauthorization of the SFRBTF and expenditure of Boat Safety funds for the National RBS Program was enacted in 2005 in the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users or SAFETEA-LU (P.L. 109-59)* and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005 (P.L. 109-74)*.

### **Immigration Examination Fees**

In 1988, Congress established the Immigration Examination Fee Account (IEFA) and the fees deposited into the IEFA have been the primary source of funding for providing immigration and naturalization benefits, and other benefits as directed by Congress. The Immigration and Nationality Act (INA) provides for the collection of fees at a level that will ensure recovery of the full costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allow the collection, safeguarding, and accounting for fees. The authority provided by section 286(m) of the INA permits USCIS to recover the full costs of providing all immigration adjudication and naturalization services, including those services provided to individuals other than those paying fees.

The primary sources of revenue are the application and petition fees that are collected during the course of the fiscal year and deposited into the Immigration Examinations Fee Account (Treasury

Account Fund Symbol (TAFS) 70X5088). In addition, USCIS provides specific services to other Federal agencies, such as production of Border Crossing Cards for the Department of State, that result in the collection of other revenues that are the result of intragovernmental activities.

During FY 2007, two events occurred that impacted fee revenue resources, including the fee increase and the visa open window for employment benefits.

### **National Flood Insurance Program**

The National Flood Insurance Program (NFIP) was established by the *National Flood Insurance Act of 1968*. The purpose of NFIP is to better indemnify individuals for flood losses through insurance, reduce future flood damages through State and community floodplain management regulations, and reduce Federal expenditures for disaster assistance and flood control.

The *Flood Disaster Protection Act of 1973* expanded the authority of FEMA and its use of the NFIP to grant premium subsidies as an additional incentive to encourage widespread state, community, and property owner acceptance of the program requirements.

The *National Flood Insurance Reform Act of 1994* reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

The *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act (FIRA) of 2004* provides additional tools for addressing the impact of repetitive loss properties on the National Flood Insurance Fund. It introduced a pilot project through fiscal year 2009 that defines severe repetitive loss properties, authorizes additional funds for mitigation projects, and mandates a 50 percent increase of premiums for property owners who decline a mitigation offer, along with an appeal process. It also modifies the Flood Mitigation Assistance (FMA) Program by doubling the annual authorized funding level and directing it to give priority to those properties that are in the best interest of the National Flood Insurance Fund.

The NFIP requires all partners (Write Your Own (WYO) Companies) in the program to submit financial statements and statistical data to the Bureau & Statistical Agent (B&SA) on a monthly basis. This information is reconciled and the WYO companies are required to correct any variances.

This program is an insurance program for which the Department pays claims to policyholders whose houses have been flooded. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are to only be used to pay claims caused by flooding.

The NFIP sources of revenue and other financing comes from premiums collected to insure policyholders homes and the borrowing authority provided to our program from Congress. The resources are inflows to the Government and are not the result of intragovernmental flows.

## **All Other Earmarked Funds**

The balances and activity reported for all other earmarked funds result from the funds listed below. Information related to these earmarked funds can be located in the Department's appropriations legislation or the statutes referenced.

- 70X0715 Radiological Emergency Preparedness Program, Emergency Preparedness and Response, Department of Homeland Security
- 70X5089 Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5087 Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126 Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378 Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)
- 70X5382 Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385 Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)
- 70\_5389 Nonimmigrant Petitioner Account, US Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356 (s)
- 70X5390 Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5436 Radiological Emergency Preparedness Fund, Department of Homeland Security; 116 Stat. 2135
- 70X5451 Immigration Enforcement Account, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5464 Flood Map Modernization Fund, Emergency Preparedness and Response, Department of Homeland Security; 116 Stat. 2135
- 70X5694 User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8149 Boat Safety, Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8244 Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135 (FEMA REPORTED)
- 70X8312 Oil Spill Liability Trust Fund, Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70\_8314 Trust Fund Share of Expenses, Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8349 Oil Spill Recovery, Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533 General Gift Fund, Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870 Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 20X8185 Oil Spill Liability Trust Fund; 103 Stat. 2363, 2364
- 70\_5106 H-1 B Nonimmigrant Petitioner Account, Department of Homeland Security; 116 Stat. 2135
- 70X8360 Gifts and Bequests, FLETC, Department of Homeland Security; 116 Stat. 2135

## 23. Intragovernmental Costs and Exchange Revenue

For the year ended September 30, 2007 (in millions) (Unaudited)

| Directorates and Other Components                          | Intragovernmental Consolidated | With the Public | Total         |
|--|--------------------------------|-----------------|---------------|
| <b><i>U.S. Customs and Border Protection</i></b>           |                                |                 |               |
| Gross Cost   | \$2,089                        | \$6,109         | \$8,198       |
| Less Earned Revenue  | (46)                           | (111)           | (157)         |
| <b>Net Cost</b>  | <b>2,043</b>                   | <b>5,998</b>    | <b>8,041</b>  |
| <b><i>U.S. Coast Guard</i></b>                             |                                |                 |               |
| Gross Cost   | 1,188                          | 9,376           | 10,564        |
| Less Earned Revenue  | (372)                          | (120)           | (492)         |
| <b>Net Cost</b>  | <b>816</b>                     | <b>9,256</b>    | <b>10,072</b> |
| <b><i>U.S. Citizenship and Immigration Services</i></b>    |                                |                 |               |
| Gross Cost   | 569                            | 1,162           | 1,731         |
| Less Earned Revenue  | (13)                           | (1,646)         | (1,659)       |
| <b>Net Cost</b>  | <b>556</b>                     | <b>(484)</b>    | <b>72</b>     |
| <b><i>Federal Emergency Management Agency</i></b>          |                                |                 |               |
| Gross Cost   | 2,579                          | 11,693          | 14,272        |
| Less Earned Revenue  | (98)                           | (2,744)         | (2,842)       |
| <b>Net Cost</b>  | <b>2,481</b>                   | <b>8,949</b>    | <b>11,430</b> |
| <b><i>Federal Law Enforcement Training Center</i></b>      |                                |                 |               |
| Gross Cost   | 29                             | 373             | 402           |
| Less Earned Revenue  | (37)                           | (3)             | (40)          |
| <b>Net Cost</b>  | <b>(8)</b>                     | <b>370</b>      | <b>362</b>    |
| <b><i>National Protection and Programs Directorate</i></b> |                                |                 |               |
| Gross Cost   | 438                            | 417             | 855           |
| Less Earned Revenue  | -                              | -               | -             |
| <b>Net Cost</b>  | <b>438</b>                     | <b>417</b>      | <b>855</b>    |
| <b><i>U.S. Immigration and Customs Enforcement</i></b>     |                                |                 |               |
| Gross Cost   | 1,168                          | 3,723           | 4,891         |
| Less Earned Revenue  | (783)                          | (117)           | (900)         |
| <b>Net Cost</b>  | <b>385</b>                     | <b>3,606</b>    | <b>3,991</b>  |
| <b><i>Office of Health Affairs</i></b>                     |                                |                 |               |
| Gross Cost   | 1                              | 4               | 5             |
| Less Earned Revenue  | -                              | -               | -             |
| <b>Net Cost</b>  | <b>1</b>                       | <b>4</b>        | <b>5</b>      |

| Directorates and Other Components                    | Intragovernmental<br>Consolidated | With<br>the<br>Public | Total           |
|--|-----------------------------------|-----------------------|-----------------|
| <b><i>Departmental Operations and Other</i></b>      |                                   |                       |                 |
| Gross Cost   | \$442                             | \$762                 | \$1,204         |
| Less Earned Revenue                                  | (2)                               | (1)                   | (3)             |
| <b>Net Cost</b>                                      | <b>440</b>                        | <b>761</b>            | <b>1,201</b>    |
| <b><i>U.S. Secret Service</i></b>                    |                                   |                       |                 |
| Gross Cost   | 487                               | 1,202                 | 1,689           |
| Less Earned Revenue                                  | (16)                              | -                     | (16)            |
| <b>Net Cost</b>                                      | <b>471</b>                        | <b>1,202</b>          | <b>1,673</b>    |
| <b><i>Science and Technology Directorate</i></b>     |                                   |                       |                 |
| Gross Cost   | 583                               | 404                   | 987             |
| Less Earned Revenue                                  | (14)                              | -                     | (14)            |
| <b>Net Cost</b>                                      | <b>569</b>                        | <b>404</b>            | <b>973</b>      |
| <b><i>Transportation Security Administration</i></b> |                                   |                       |                 |
| Gross Cost   | 1,394                             | 5,045                 | 6,439           |
| Less Earned Revenue                                  | (2)                               | (2,297)               | (2,299)         |
| <b>Net Cost</b>                                      | <b>1,392</b>                      | <b>2,748</b>          | <b>4,140</b>    |
| <b>Total Department of Homeland Security</b>         |                                   |                       |                 |
| Gross Cost   | 10,967                            | 40,270                | 51,237          |
| Less Earned Revenue                                  | (1,383)                           | (7,039)               | (8,422)         |
| <b>Net Cost</b>                                      | <b>\$9,584</b>                    | <b>\$33,231</b>       | <b>\$42,815</b> |

**For the year ended September 30, 2006 (in millions) (Unaudited) (Restated)**

| <b>Directorates and Other Components</b>                   | <b>Intragovernmental Consolidated</b> | <b>With the Public</b> | <b>Total</b>  |
|--|---------------------------------------|------------------------|---------------|
| <b><i>U.S. Customs and Border Protection</i></b>           |                                       |                        |               |
| Gross Cost   | \$1,787                               | \$5,348                | \$7,135       |
| Less Earned Revenue  | (47)                                  | (106)                  | (153)         |
| <b>Net Cost</b>  | <b>1,740</b>                          | <b>5,242</b>           | <b>6,982</b>  |
| <b><i>U.S. Coast Guard</i></b>                             |                                       |                        |               |
| Gross Cost   | 1,105                                 | 8,906                  | 10,011        |
| Less Earned Revenue  | (332)                                 | (92)                   | (424)         |
| <b>Net Cost</b>  | <b>773</b>                            | <b>8,814</b>           | <b>9,587</b>  |
| <b><i>U.S. Citizenship and Immigration Services</i></b>    |                                       |                        |               |
| Gross Cost   | 493                                   | 1,095                  | 1,588         |
| Less Earned Revenue  | (15)                                  | (1,714)                | (1,729)       |
| <b>Net Cost</b>  | <b>478</b>                            | <b>(619)</b>           | <b>(141)</b>  |
| <b><i>Federal Emergency Management Agency</i></b>          |                                       |                        |               |
| Gross Cost   | 6,228                                 | 22,617                 | 28,845        |
| Less Earned Revenue  | (120)                                 | (2,349)                | (2,469)       |
| <b>Net Cost</b>  | <b>6,108</b>                          | <b>20,268</b>          | <b>26,376</b> |
| <b><i>Federal Law Enforcement Training Center</i></b>      |                                       |                        |               |
| Gross Cost   | 26                                    | 286                    | 312           |
| Less Earned Revenue  | (31)                                  | (2)                    | (33)          |
| <b>Net Cost</b>  | <b>(5)</b>                            | <b>284</b>             | <b>279</b>    |
| <b><i>National Protection and Programs Directorate</i></b> |                                       |                        |               |
| Gross Cost   | 391                                   | 352                    | 743           |
| Less Earned Revenue  | (1)                                   | -                      | (1)           |
| <b>Net Cost</b>  | <b>390</b>                            | <b>352</b>             | <b>742</b>    |
| <b><i>U.S. Immigration and Customs Enforcement</i></b>     |                                       |                        |               |
| Gross Cost   | 1,179                                 | 3,321                  | 4,500         |
| Less Earned Revenue  | (757)                                 | (100)                  | (857)         |
| <b>Net Cost</b>  | <b>422</b>                            | <b>3,221</b>           | <b>3,643</b>  |
| <b><i>Office of Health Affairs</i></b>                     |                                       |                        |               |
| Gross Cost   | 53                                    | -                      | 53            |
| Less Earned Revenue  | -                                     | -                      | -             |
| <b>Net Cost</b>  | <b>53</b>                             | <b>-</b>               | <b>53</b>     |

| Directorates and Other Components                    | Intragovernmental Consolidated | With the Public | Total           |
|--|--------------------------------|-----------------|-----------------|
| <b><i>Department Operations and Other</i></b>        |                                |                 |                 |
| Gross Cost   | \$288                          | 564             | \$852           |
| Less Earned Revenue                                  | (2)                            | -               | (2)             |
| <b>Net Cost</b>                                      | <b>286</b>                     | <b>564</b>      | <b>850</b>      |
| <b><i>U.S. Secret Service</i></b>                    |                                |                 |                 |
| Gross Cost   | 403                            | 1,068           | 1,471           |
| Less Earned Revenue                                  | (18)                           | -               | (18)            |
| <b>Net Cost</b>                                      | <b>385</b>                     | <b>1,068</b>    | <b>1,453</b>    |
| <b><i>Science and Technology Directorate</i></b>     |                                |                 |                 |
| Gross Cost   | 467                            | 376             | 843             |
| Less Earned Revenue                                  | -                              | -               | -               |
| <b>Net Cost</b>                                      | <b>467</b>                     | <b>376</b>      | <b>843</b>      |
| <b><i>Transportation Security Administration</i></b> |                                |                 |                 |
| Gross Cost   | 1,194                          | 4,807           | 6,001           |
| Less Earned Revenue                                  | (5)                            | (2,472)         | (2,477)         |
| <b>Net Cost</b>                                      | <b>1,189</b>                   | <b>2,335</b>    | <b>3,524</b>    |
| <b>Total Department of Homeland Security</b>         |                                |                 |                 |
| Gross Cost   | 13,614                         | 48,740          | 62,354          |
| Less Earned Revenue                                  | (1,328)                        | (6,835)         | (8,163)         |
| <b>Net Cost</b>                                      | <b>\$12,286</b>                | <b>\$41,905</b> | <b>\$54,191</b> |

Intragovernmental costs represent exchange transactions made between two reporting entities within the Federal Government and are presented separately from costs with the public (exchange transactions made between the reporting entity and a non-Federal entity). Intragovernmental exchange revenue is disclosed separately from exchange revenue with the public. The criteria used for this classification requires that the intragovernmental expenses relate to the source of goods and services purchased by the reporting entity and not to the classification of related revenue. For example, with “exchange revenue with the public,” the buyer of the goods or services is a non-Federal entity. With “intragovernmental costs,” the buyer and seller are both Federal entities. If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue would be classified as “with the public,” but the related costs would be classified as “intragovernmental.” The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

## 24. Suborganization Costs by DHS Goals

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue. A responsibility segment is the component that carries out a mission or major line of activity, and whose managers report directly to Departmental Management.

To integrate performance and financial information, as required by the *President's Management Agenda* and the *Government Performance and Results Act*, a supplemental schedule of net cost is included in this note, in which costs by component are allocated to Departmental strategic goals. The Department is currently in the process of revising its strategic goals. Until the goals are finalized and approved, the Department has elected to use the Secretary's two year goals as the basis for integrating FY 2007 net costs to performance information. For FY 2006, certain amounts have been reclassified to reflect the new organization structure conforming to the PKEMR Act. However, FY 2006 net cost information is presented by FY2006 strategic goals consistent with the FY 2006 Performance and Accountability Report (PAR), and have not been reclassified to be consistent with the current year presentation based on Secretary's two year goals.



**Net Costs of Department Sub-organizations by Secretary's Goals (in millions)**  
**For the year ended September 30, 2007 (Unaudited)**

|  | <b>Protect our<br/>Nation from<br/>Dangerous<br/>People</b> | <b>Protect<br/>our Nation<br/>from<br/>Dangerous<br/>Goods</b> | <b>Protect<br/>Critical<br/>Infrastructure</b> | <b>Emergency<br/>Response<br/>System and<br/>Culture of<br/>Preparedness</b> | <b>Strengthen<br/>and Unify<br/>DHS<br/>Operations<br/>and<br/>Management</b> | <b>TOTAL</b>     |
|--|---|--|--|--|---|------------------|
| U.S. Customs and Border Protection           | \$8,041   | \$ -   | \$ -   | \$ -   | \$ -  | <b>\$8,041</b>   |
| U.S. Coast Guard                             | 2,798   | -  | 5,981  | 1,293  | -   | <b>10,072</b>    |
| U.S. Citizenship and Immigration Services    | 72  | -  | -  | -  | -   | <b>72</b>        |
| Federal Emergency Management Agency          | -   | -  | -  | 11,430   | -   | <b>11,430</b>    |
| Federal Law Enforcement Training Center      | -   | -  | -  | 362  | -   | <b>362</b>       |
| National Protection and Programs Directorate | 285   | -  | 539  | 31   | -   | <b>855</b>       |
| U.S. Immigration and Customs Enforcement     | 4,219   | -  | (228)  | -  | -   | <b>3,991</b>     |
| Office of Health Affairs                     | -   | 2  | -  | 3  | -   | <b>5</b>         |
| Departmental Operations and Other            | -   | 106  | -  | -  | 1,095   | <b>1,201</b>     |
| U.S. Secret Service                          | -   | -  | 1,673  | -  | -   | <b>1,673</b>     |
| Science and Technology Directorate           | 30  | 475  | 157  | 311  | -   | <b>973</b>       |
| Transportation and Security Administration   | 589   | -  | 3,551  | -  | -   | <b>4,140</b>     |
| <b>TOTAL Department</b>                      | <b>\$16,034</b>   | <b>\$583</b>   | <b>\$11,673</b>                                | <b>\$13,430</b>  | <b>\$1,095</b>  | <b>\$42, 815</b> |

**Net Costs of Department Sub-organizations by Strategic Goals (in millions)**  
**For the year ended September 30, 2006 (Unaudited) (Restated)**

|  | Awareness      | Prevention      | Protection      | Response       | Recovery       | Service        | Organizational<br>Excellence | TOTAL           |
|--|----------------|-----------------|-----------------|----------------|----------------|----------------|------------------------------|-----------------|
| U.S. Customs and Border Protection           | \$ -           | \$ 6,535        | \$ -            | \$ -           | \$ -           | \$ 447         | \$ -                         | <b>\$ 6,982</b> |
| U.S. Coast Guard                             | 1,055          | 4,184           | 1,552           | 1,231          | 57             | 1,508          | -                            | <b>9,587</b>    |
| U.S. Citizenship and Immigration Services    | -              | (40)            | -               | -              | -              | (101)          | -                            | <b>(141)</b>    |
| Federal Emergency Management Administration  | -              | -               | 16,621          | 4,509          | 5,246          | -              | -                            | <b>26,376</b>   |
| Federal Law Enforcement Training Center      | -              | 279             | -               | -              | -              | -              | -                            | <b>279</b>      |
| National Protection and Programs Directorate | 190            | 144             | 290             | -              | -              | 118            | -                            | <b>742</b>      |
| U.S. Immigration and Customs Enforcement     | -              | 3,324           | 319             | -              | -              | -              | -                            | <b>3,643</b>    |
| Office of Health Affairs                     | -              | -               | 53              | -              | -              | -              | -                            | <b>53</b>       |
| Departmental Operations and Other            | 86             | -               | -               | -              | -              | -              | 764                          | <b>850</b>      |
| U.S. Secret Service                          | -              | -               | 1,453           | -              | -              | -              | -                            | <b>1,453</b>    |
| Science and Technology Directorate           | 133            | 460             | 78              | 136            | 36             | -              | -                            | <b>843</b>      |
| Transportation and Security Administration   | 4              | 3,330           | 190             | -              | -              | -              | -                            | <b>3,524</b>    |
| <b>TOTAL Department</b>                      | <b>\$1,468</b> | <b>\$18,216</b> | <b>\$20,556</b> | <b>\$5,876</b> | <b>\$5,339</b> | <b>\$1,972</b> | <b>\$764</b>                 | <b>\$54,191</b> |

## 25. Apportionment Categories of Obligations Incurred: Direct versus Reimbursable Obligations

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other time periods, for activities, projects, or objectives, or for any combination thereof (in millions).

| <b>Year Ended September 30, 2007<br/>(Unaudited):</b> | <b>Apportionment<br/>Category A</b> | <b>Apportionment<br/>Category B</b> | <b>Exempt from<br/>Apportionment</b> | <b>Total</b>    |
|---|-------------------------------------|-------------------------------------|--------------------------------------|-----------------|
| Obligations Incurred - Direct                         | \$30,748                            | \$24,341                            | \$1,593                              | \$56,682        |
| Obligations Incurred - Reimbursable                   | 4,584                               | 736                                 | -                                    | 5,320           |
| <b>Total Obligations Incurred</b>                     | <b>\$35,332</b>                     | <b>\$25,077</b>                     | <b>\$1,593</b>                       | <b>\$62,002</b> |

| <b>Year Ended September 30, 2006<br/>(Unaudited) (Restated):</b> | <b>Apportionment<br/>Category A</b> | <b>Apportionment<br/>Category B</b> | <b>Exempt from<br/>Apportionment</b> | <b>Total</b>    |
|--|-------------------------------------|-------------------------------------|--------------------------------------|-----------------|
| Obligations Incurred - Direct                                    | \$27,786                            | \$58,004                            | \$993                                | \$86,783        |
| Obligations Incurred - Reimbursable                              | 3,690                               | 788                                 | 9                                    | 4,487           |
| <b>Total Obligations Incurred</b>                                | <b>\$31,476</b>                     | <b>\$58,792</b>                     | <b>\$1,002</b>                       | <b>\$91,270</b> |

The decrease in obligation of Apportionment Category B for Obligations Incurred - Direct was related to FEMA's payments of approved claims from Hurricane Katrina which were obligated and paid during FY 2006.

## 26. Available Borrowing Authority

The Department, through FEMA's NFIP, has total borrowing authority of \$4.2 billion (unaudited), as of September 30, 2007, available for disaster relief purposes. The borrowing authority consists of \$4.2 billion in borrowing authority carried forward from FY 2006. During FY 2007, FEMA used \$695 million in borrowing authority; the remaining balance of \$3.5 billion represents the total unused portion. As of September 30, 2006, FEMA used \$16.8 billion in borrowing authority; the remaining balance of \$4.2 billion represents the total unused portion. DADLP annually requests borrowing authority to cover the principal amount of direct loans not to exceed \$25 million less the subsidy due from the program account.

## 27. Permanent Indefinite Appropriations

Permanent indefinite appropriations refer to the appropriations that result from permanent public laws, which authorize the Department to retain certain receipts. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has two permanent indefinite appropriations as follows:

- CBP has a permanent and indefinite appropriation, which is used to disburse tax and duty refunds, and duty drawbacks. Although funded through appropriations, refund and drawback activity is, in most instances, reported as a custodial activity of the Department. Refunds are custodial revenue-related activity in that refunds are a direct result of overpayments of taxes, duties, and fees. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the Statement of Net Cost. Likewise, the refunds of overpayments are not available for use by the Department in its operations.
- USSS has a permanent and indefinite appropriation, which is used to reimburse the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) for the difference between benefits to participants in the DC Pension Plan (see Note 16), and payroll contributions received from current employees.

These appropriations are not subject to budgetary ceilings established by Congress. CBP's refunds payable at year-end are not subject to funding restrictions.

## **28. Legal Arrangements Affecting the Use of Unobligated Balances**

Unobligated balances, whose period of availability has expired, are not available to fund new obligations. Expired unobligated balances are available to pay for current period adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled and returned to Treasury. For a no-year account, the unobligated balance is carried forward indefinitely until: (1) specifically rescinded by law; or (2) the head of the agency concerned or the President determines that the purposes for which the appropriation was made have been carried out and disbursements have not been made against the appropriation for two consecutive years.

Included in the cumulative results of operations for special funds is \$1.1 billion (unaudited) and \$1.2 billion (unaudited) at September 30, 2007 and 2006, respectively, that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing; to assess and collect fees associated with services performed at certain small airports or other facilities; retain amounts needed to offset costs associated with collecting duties; and taxes and fees for the government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. Part of the passenger fees in the User Fees Account, totaling approximately \$758 million (unaudited) and \$761 million (unaudited) at September 30, 2007 and 2006, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department Appropriation Acts.

The entity trust fund balances result from the Department's authority to use the proceeds from general order items sold at auction to offset specific costs incurred by the Department relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

## 29. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the material differences between the 2006 Statement of Budgetary Resources (SBR) and the actual amounts reported for 2006 in the Budget of the U.S. Government. Since the FY 2007 financial statements will be reported prior to the release of the Budget of the U.S. Government, DHS is reporting for 2006 only. Typically, the Budget of the U.S. Government with the 2007 actual data is published in February of the subsequent year. Once published the 2007 actual data will be available on the OMB website, [www.whitehouse.gov/omb](http://www.whitehouse.gov/omb).

| <b>(in millions)</b>  | <b>Budgetary<br/>Resources</b> | <b>Obligations<br/>Incurred</b> | <b>Distributed<br/>Offsetting<br/>Receipts</b> | <b>Net<br/>Outlays</b> |
|---|--------------------------------|---------------------------------|--|------------------------|
| <b>2006 Actual Balances per the 2008<br/>President's Budget</b>   | \$105,857                      | \$89,512                        | \$4,844  | \$74,103               |
| <b>Reconciling Items:</b>   |                                |                                 |  |                        |
| Accounts that are expired that are not<br>included in Budget of the United States.  | 1,494                          | 556                             |  |                        |
| Distributed Offsetting Receipts not included<br>in the Budget of the United States.   |                                |                                 |  | (4,842)                |
| Refunds and drawbacks not included in the<br>Budget of the United States.   | 891                            | 891                             |  | 891                    |
| Byrd Program not included in the Budget of<br>the United States.  | 792                            | 226                             |  | 226                    |
| Timing differences related to the reporting<br>of an Anti-Deficiency Act violation.   | (248)                          |                                 |  |                        |
| Differences in reporting methodologies<br>between the Budget of the United States and<br>the SBR related to prior year fee collections. | (80)                           | (18)                            |  |                        |
| Miscellaneous Differences   | (132)                          | 103                             | (23)   | 36                     |
| <b>Per the 2006 SBR (Unaudited) (Restated)</b>  | <b>\$108,574</b>               | <b>\$91,270</b>                 | <b>\$4,821</b>                                 | <b>\$70,414</b>        |

## 30. Undelivered Orders, End of Period

An undelivered order exists when a valid obligation has occurred and funds have been reserved, but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2007 and 2006 were \$38,435 million (unaudited) and \$36,914 million (unaudited) (restated), respectively.

### 31. Explanation for the Difference between the Appropriations Received reported on the Statement of Budgetary Resources and on the Statement of Changes in Net Position

The Statement of Budgetary Resources (SBR) reported \$46,491 million (unaudited) for appropriations received for FY 2007. This balance does not agree to the balance reported on the Statement of Changes in Net Position (SCNP) of \$39,520 million (unaudited) for FY 2007. The difference is primarily related to: (1) \$5,718 million in certain trust and special fund receipts not reflected in the unexpended appropriations section of the Statement of Changes in Net Position; (2) \$(34) million for the decrease in amounts appropriated from certain Treasury-managed trust funds; (3) \$1,611 million related to refunds and drawbacks; (4) \$(324) million for receipts unavailable for obligations upon collection from certain trust and special funds; and (5) \$1 million for a temporary reduction/cancellation returned by appropriation.

In FY 2006, appropriations received on the SBR of \$45,748 million (unaudited) (restated) did not equal the amounts reported on the Statement of Changes in Net Position of \$39,529 million (unaudited) (restated) due to: (1) \$5,177 million of trust and special fund receipts that are not reflected in the unexpended appropriation section of the SCNP; (2) \$(42) million for the decrease in amounts appropriated from specific Treasury-managed trust funds; (3) \$974 million of refunds and drawbacks; and (4) \$110 million of receipts unavailable for obligations upon collections.

### 32. Custodial Revenues

The Department collects revenue from a variety of duties, excise taxes, and various other fees, some of which are refunded. Refunds and drawbacks by entry year for the fiscal years ended September 30 (in millions):

| Entry Year                         | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|------------------------------------|---------------------|-----------------------------------|
| 2007                               | \$5,531             | \$ -                              |
| 2006                               | 222                 | 596                               |
| 2005                               | 327                 | 143                               |
| 2004                               | 363                 | 90                                |
| Prior Years                        | 479                 | 331                               |
| <b>Total Refunds and Drawbacks</b> | <b>\$6,922</b>      | <b>\$1,160</b>                    |

Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. At the time an importer's merchandise is brought into the United States, the importer is required to file entry documents. Generally, within ten working days after release of the merchandise into the United States commerce, the importer is to submit an entry document with payment of estimated duties, taxes, and fees.

The significant types of non-entity accounts receivable (custodial revenues as presented in the Statement of Custodial Activity) are described below.

- **Duties:** amounts collected on imported goods collected on behalf of the Federal Government.
- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.
- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.
- **Fines and penalties:** amounts collected for violations of laws and regulations.
- **Refunds:** overpayments of duties, taxes, fees, and interest to an importer/exporter for which the importer/exporter needs to reimburse the payer. Refunds include drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Disbursements from the refunds and drawback account for the fiscal years ended September 30, 2007 and 2006, consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Refunds                                | \$6,296             | \$646                             |
| Drawback                               | 626                 | 514                               |
| <b>Total Refunds and<br/>Drawbacks</b> | <b>\$6,922</b>      | <b>\$1,160</b>                    |

The increase in the disbursements for refunds from FY 2006 to FY 2007 relates to the payment of Canadian Softwood lumber duties previously collected and interest previously accrued. The disbursements include interest payments of \$655 million and \$111 million, for the fiscal years ended September 30, 2007 and 2006, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the Department of Commerce (DOC). These duties are refunded when the DOC issues a decision in favor of the foreign industry.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2007 and 2006, consisted of the following (in millions):

|  | 2007<br>(Unaudited) | 2006<br>(Unaudited)<br>(Restated) |
|--|---------------------|-----------------------------------|
| Antidumping and Countervailing Duty Refunds              | \$5,034             | \$381                             |
| Interest   | 655                 | 86                                |
| <b>Total Antidumping and Countervailing Duty Refunds</b> | <b>\$5,689</b>      | <b>\$467</b>                      |

### 33. National Disaster Medical Systems Transfer

The transfer of the National Disaster Medical Systems (NDMS) pursuant to P.L. 109-295 had an effect on all of Department's FY 2007 financial statements, except for Statement of Custodial Activity.

The following lines of the Department's Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources include transfer of assets, liabilities, net position, and budgetary resources of the NDMS as of January 1, 2007, the date of transfer.

#### Balance Sheet (In Millions)

|                                    |      |
|------------------------------------|------|
| Fund Balance with Treasury         | \$90 |
| Property, Plant and Equipment      | 1    |
| Total Assets                       | 91   |
| Accounts Payable                   | 2    |
| Unexpended Appropriations          | 88   |
| Cumulative Results of Operations   | 1    |
| Total Liabilities and Net Position | \$91 |

#### Statement of Changes in Net Position (In Millions)

|  |      |
|--|------|
| Appropriations Transferred In/Out -    |      |
| Unexpended Appropriations              | \$88 |
| Other Financing Sources/Non-Exchange:  |      |
| Transfers In/Out without Reimbursement | \$1  |

#### Statement of Budgetary Resources (In Millions)

|  |      |
|--|------|
| Budgetary Resources - Budget Authority - |      |
| Net Transfers, Current Year              | \$40 |
| Budgetary Resources - Budget Authority - |      |
| Net Transfers, Balances                  | \$31 |
| Changes in Obligated Balances, Actual    |      |
| transfers, unpaid obligations            | \$18 |



## 34. Restatements

### A. TSA Restatement (Unaudited)

**Aviation Security Fee Reporting.** The Department has restated the FY 2006 principle statements, excluding the Statement of Custodial Activity, and related footnotes as a result of an error in the accounting for the reduction of the Aviation Security Appropriation through a return of appropriated balances to Treasury. In prior years the security fees collected to provide aviation security were recorded as revenue. At the end of each fiscal year TSA recorded a rescission in an amount equal to the security fees and were returned to the Treasury General Fund. TSA should have been returning unexpended appropriations to Treasury equivalent to the security fees collected. The accounting treatment has been updated for FY 2007.

Prior to the implementation of this accounting change the Unexpended Appropriations were understated and the Cumulative Results of Operations were overstated. In addition, smaller adjustments were made to correct incorrect data in accounts receivable and accounts payable, also resulting in an adjustment to Cumulative Results of Operations.

**Accounts Payable Reporting.** The Department restated the FY 2006 Balance Sheet, Statement of Changes in Net Position, and the Statement of Net Cost, and related footnotes as a result of an error in recording accounts payable during FY 2005 through FY 2006 that resulted from FY 2004 and FY 2005 estimated accruals not reversed. This error caused the Accounts Payable balance to be overstated and the Unexpended Appropriations balance to be understated.

**Correction to the Statement of Budgetary Resources.** During FY 2005, TSA identified \$248 million of unrecorded obligations resulting in an adjustment to the FY 2004 Statement of Budgetary Resources, which incorrectly carried forward to the beginning balances of the FY 2006 Statement of Budgetary Resources. The beginning balances to FY 2006 were incorrectly carried forward and as a result required correction for FY 2007 reporting.

### B. ICE, USCIS, NPPD, S&T, and MGMT Restatements (Unaudited)

During FY 2007, in conjunction with their service provider, several Components began implementation of corrective action plans to identify and correct erroneous balances attributed to legacy data. As a result of these corrective actions five Components, ICE, USCIS, NPPD, S&T, and MGMT, restated their FY 2006 financial statements to correct errors in accounting. The restatement affected accounts payable, PP&E, accrued FECA liability, net position, and the associated budgetary balances. These restatements affected each of the principal financial statements, except for the Statement of Custodial Activity.

During FY 2007, US-VISIT, reported as a part of NPPD, reviewed its internal use software inventory to identify and correct costs that should have been capitalized. The corrections resulted in restating PP&E and operating expense, and affected the Balance Sheet, Statement of Net Cost, and the Statement of Changes in Net Position.

### **C. FLETC Restatement (Unaudited)**

The Department restated their FY 2006 financial statements due to FLETC's FY 2006 audit adjustments related to reclassifications of PP&E construction-in-progress projects and re-computations of capital lease amortization, which occurred after the Department's statements were published in accordance with OMB A-136. These restatements affected each of the principal financial statements, except for the Statement of Custodial Activity.

### **D. Other Restatements (Unaudited)**

Based on additional information obtained in FY 2007, the Department reclassified balances for four earmarked funds reported by OIG as a part of Departmental Operations and Others and ICE. These reclassifications affected the Balance Sheet, Statement of Changes in Net Position, and the Earmarked footnote disclosure.

The Department also recorded miscellaneous restatements resulting in a reduction in the accounts receivable and an increase to Fund Balance with Treasury. These restatements affected each of the principal financial statements, except for the Statement of Net Cost and the Statement of Custodial Activity.

| <b>BALANCE SHEET, in millions</b>           | <b>Original<br/>2006</b> | <b>Effects of<br/>Restatements</b> | <b>Restated<br/>2006</b> | <b>Description<br/>Reference</b> |
|---|--------------------------|------------------------------------|--------------------------|----------------------------------|
| <b>ASSETS</b>                               |                          |                                    |                          |                                  |
| <b>Intragovernmental</b>                    |                          |                                    |                          |                                  |
| Fund Balance With Treasury                  | \$59,568                 | \$1                                | \$59,569                 | D                                |
| Investments, Net                            | 634                      | -                                  | 634                      |                                  |
| Accounts Receivable                         | 248                      | (1)                                | 247                      | D                                |
| Other                                       |                          |                                    |                          |                                  |
| Advances and Prepayments                    | 2,912                    | 1                                  | 2,913                    | B                                |
| Due from Treasury                           | 411                      |                                    | 411                      |                                  |
| <b>Total Intragovernmental</b>              | <b>\$63,773</b>          | <b>\$1</b>                         | <b>\$63,774</b>          |                                  |
|   |                          |                                    |                          |                                  |
| Cash and Other Monetary Assets              | \$99                     | \$ -                               | \$99                     |                                  |
| Accounts Receivable, Net                    | 1,181                    | -                                  | 1,181                    |                                  |
| Taxes, Duties, and Trade Receivables, Net   | 1,755                    | -                                  | 1,755                    |                                  |
| Direct Loans, Net                           | 161                      | -                                  | 161                      |                                  |
| Inventory and Related Property, Net         | 677                      | -                                  | 677                      |                                  |
| General Property, Plant, and Equipment, Net | 11,036                   | 115                                | 11,151                   | B, C                             |
| Other                                       |                          |                                    |                          |                                  |
| Advances and Prepayments                    | 551                      | -                                  | 551                      |                                  |
| <b>TOTAL ASSETS</b>                         | <b>\$79,233</b>          | <b>\$116</b>                       | <b>\$79,349</b>          |                                  |
| <b>LIABILITIES</b>                          |                          |                                    |                          |                                  |
| <b>Intragovernmental</b>                    |                          |                                    |                          |                                  |
| Accounts Payable                            | \$1,900                  | \$7                                | \$1,907                  | B                                |
| Debt  | 17,446                   | -                                  | 17,446                   |                                  |
| Other                                       |                          |                                    |                          |                                  |
| Due to the General Fund                     | 1,809                    | -                                  | 1,809                    |                                  |
| Accrued FECA Liability                      | 323                      | 16                                 | 339                      | B                                |
| Other                                       | 187                      | -                                  | 187                      |                                  |
| <b>Total Intragovernmental</b>              | <b>\$21,665</b>          | <b>\$23</b>                        | <b>\$21,688</b>          |                                  |
|   |                          |                                    |                          |                                  |
| Accounts Payable                            | \$2,765                  | \$(136)                            | \$2,629                  | A, B                             |
| Federal Employee and Veteran Benefits       | 32,278                   | -                                  | 32,278                   |                                  |
| Environmental and Disposal Liabilities      | 245                      | -                                  | 245                      |                                  |
| Other                                       |                          |                                    |                          |                                  |
| Accrued Payroll                             | 1,362                    | -                                  | 1,362                    |                                  |
| Deferred Revenue and Advances from          |                          |                                    |                          |                                  |
| Others                                      | 2,188                    | -                                  | 2,188                    |                                  |
| Deposit Liability for Canadian Softwood     |                          |                                    |                          |                                  |
| Lumber                                      | 34                       | -                                  | 34                       |                                  |

| <b>BALANCE SHEET, in millions</b>                 | <b>Original<br/>2006</b> | <b>Effects of<br/>Restatements</b> | <b>Restated<br/>2006</b> | <b>Description<br/>Reference</b> |
|---|--------------------------|------------------------------------|--------------------------|----------------------------------|
| Insurance Liabilities                             | 3,567                    | -                                  | 3,567                    |                                  |
| Refunds and Drawbacks                             | 5,593                    | -                                  | 5,593                    |                                  |
| Other   | 1,190                    | 15                                 | 1,205                    | C                                |
| <b>Total Liabilities</b>                          | <b>\$70,887</b>          | <b>\$(98)</b>                      | <b>\$70,789</b>          |                                  |
| <b>Net Position</b>                               |                          |                                    |                          |                                  |
| Unexpended Appropriations- Earmarked Funds        | \$18                     | \$(18)                             | \$ -                     | D                                |
| Unexpended Appropriations- Other Funds            | 48,084                   | 732                                | 48,816                   | A, B, D                          |
| Cumulative Results of Operations- Earmarked Funds | (19,328)                 | (9)                                | (19,337)                 | D                                |
| Cumulative Results of Operations-Other Funds      | (20,428)                 | (491)                              | (20,919)                 | A, B, C, D                       |
| <b>Total Net Position</b>                         | <b>8,346</b>             | <b>214</b>                         | <b>8,560</b>             |                                  |
| <b>TOTAL LIABILITIES AND NET POSITION</b>         | <b>\$79,233</b>          | <b>\$116</b>                       | <b>\$79,349</b>          |                                  |

| STATEMENT OF NET COST,<br>in millions                              | Reclassified<br>2006 <sup>2</sup> | Effects of<br>Restatements | Restated<br>2006 | Description<br>Reference |
|--|-----------------------------------|----------------------------|------------------|--------------------------|
| <b>Directorates and Other<br/>Components</b>                       |                                   |                            |                  |                          |
| <b><i>U.S. Customs and Border Protection</i></b>                   |                                   |                            |                  |                          |
| Gross Cost   | \$7,135                           | \$ -                       | \$7,135          |                          |
| Less Earned Revenue  | (153)                             | -                          | (153)            |                          |
| <b>Net Cost</b>  | <b>6,982</b>                      | <b>-</b>                   | <b>6,982</b>     |                          |
| <b><i>U.S. Coast Guard</i></b>                                     |                                   |                            |                  |                          |
| Gross Cost   | 10,011                            | -                          | 10,011           |                          |
| Less Earned Revenue  | (424)                             | -                          | (424)            |                          |
| <b>Net Cost</b>  | <b>9,587</b>                      | <b>-</b>                   | <b>9,587</b>     |                          |
| <b><i>U.S. Citizenship and Immigration<br/>Services</i></b>        |                                   |                            |                  |                          |
| Gross Cost   | 1,609                             | (21)                       | 1,588            | B                        |
| Less Earned Revenue  | (1,729)                           | -                          | (1,729)          |                          |
| <b>Net Cost</b>  | <b>(120)</b>                      | <b>(21)</b>                | <b>(141)</b>     |                          |
| <b><i>Federal Emergency Management<br/>Agency</i></b>              |                                   |                            |                  |                          |
| Gross Cost   | 28,845                            | -                          | 28,845           |                          |
| Less Earned Revenue  | (2,469)                           | -                          | (2,469)          |                          |
| <b>Net Cost</b>  | <b>26,376</b>                     | <b>-</b>                   | <b>26,376</b>    |                          |
| <b><i>Federal Law Enforcement Training<br/>Center</i></b>          |                                   |                            |                  |                          |
| Gross Cost   | 312                               | -                          | 312              |                          |
| Less Earned Revenue  | (33)                              | -                          | (33)             |                          |
| <b>Net Cost</b>  | <b>279</b>                        | <b>-</b>                   | <b>279</b>       |                          |
| <b><i>National Protection and<br/>Preparedness Directorate</i></b> |                                   |                            |                  |                          |
| Gross Cost   | 820                               | (77)                       | 743              | B                        |
| Less Earned Revenue  | (1)                               | -                          | (1)              |                          |
| <b>Net Cost</b>  | <b>819</b>                        | <b>(77)</b>                | <b>742</b>       |                          |
| <b><i>U.S. Immigration and Customs<br/>Enforcement</i></b>         |                                   |                            |                  |                          |
| Gross Cost   | 4,487                             | 13                         | 4,500            | B                        |
| Less Earned Revenue  | (857)                             | -                          | (857)            |                          |
| <b>Net Cost</b>  | <b>3,630</b>                      | <b>13</b>                  | <b>3,643</b>     |                          |

<sup>2</sup> As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2006 financial statements have been reclassified to conform with the FY 2007 presentation.

| <b>STATEMENT OF NET COST,<br/>in millions</b>            | <b>Reclassified<br/>2006<sup>2</sup></b> | <b>Effects of<br/>Restatements</b> | <b>Restated<br/>2006</b> | <b>Description<br/>Reference</b> |
|--|--|------------------------------------|--------------------------|----------------------------------|
| <i><b>Department Operations and Other</b></i>            |  |                                    |                          |                                  |
| Gross Cost   | 852                                      | -                                  | 852                      |                                  |
| Less Earned Revenue                                      | (2)                                      | -                                  | (2)                      |                                  |
| <b>Net Cost</b>  | <b>850</b>                               | <b>-</b>                           | <b>850</b>               |                                  |
| <i><b>Office of Health Affairs</b></i>                   |  |                                    |                          |                                  |
| Gross Cost   | 53                                       | -                                  | 53                       |                                  |
| Less Earned Revenue                                      | -  | -                                  | -                        |                                  |
| <b>Net Cost</b>  | <b>53</b>                                | <b>-</b>                           | <b>53</b>                |                                  |
| <i><b>U.S. Secret Service</b></i>                        |  |                                    |                          |                                  |
| Gross Cost   | 1,471                                    | -                                  | 1,471                    |                                  |
| Less Earned Revenue                                      | (18)                                     | -                                  | (18)                     |                                  |
| <b>Net Cost</b>  | <b>1,453</b>                             | <b>-</b>                           | <b>1,453</b>             |                                  |
| <i><b>Science and Technology Directorate</b></i>         |  |                                    |                          |                                  |
| Gross Cost   | 843                                      | -                                  | 843                      |                                  |
| Less Earned Revenue                                      | -  | -                                  | -                        |                                  |
| <b>Net Cost</b>  | <b>843</b>                               | <b>-</b>                           | <b>843</b>               |                                  |
| <i><b>Transportation Security<br/>Administration</b></i> |  |                                    |                          |                                  |
| Gross Cost   | 6,043                                    | (42)                               | 6,001                    | A                                |
| Less Earned Revenue                                      | (2,477)                                  | -                                  | (2,477)                  |                                  |
| <b>Net Cost</b>  | <b>3,566</b>                             | <b>(42)</b>                        | <b>3,524</b>             |                                  |
| <b>NET COST OF OPERATIONS</b>                            | <b>\$54,318</b>                          | <b>(\$127)</b>                     | <b>\$54,191</b>          |                                  |

<sup>2</sup> As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2006 financial statements have been reclassified to conform with the FY 2007 presentation.

| <b>STATEMENT OF CHANGES IN NET POSITION, in millions</b>  | <b>Original<br/>2006</b> | <b>Effects of<br/>Restatements</b> | <b>Restated<br/>2006</b> | <b>Description<br/>Reference</b> |
|---|--------------------------|------------------------------------|--------------------------|----------------------------------|
| <b>Cumulative Results of Operations</b>                   |                          |                                    |                          |                                  |
| Beginning Balances  | \$(41,847)               | \$ -                               | \$(41,847)               |                                  |
| Adjustments:  |                          |                                    |                          |                                  |
| Changes in accounting principles                          | -                        | -                                  | -                        |                                  |
| Corrections of Errors                                     | -                        | (588)                              | (588)                    | A, B, C                          |
| Beginning balance, as adjusted                            | <b>\$(41,847)</b>        | <b>\$(588)</b>                     | <b>\$(42,435)</b>        |                                  |
| <b>Budgetary Financing Sources:</b>                       |                          |                                    |                          |                                  |
| Appropriations Used                                       | \$52,895                 | \$(23)                             | \$52,872                 | A, B, D                          |
| Non-Exchange Revenue                                      | 2,527                    | -                                  | 2,527                    |                                  |
| Donations and Forfeitures of Cash and<br>Cash Equivalents | 68                       | -                                  | 68                       |                                  |
| Transfers in/out without<br>Reimbursement                 | 362                      | (1)                                | 361                      | D                                |
| Other   | (181)                    | (15)                               | (196)                    |                                  |
| <b>Other Financing Sources (Non-<br/>Exchange):</b>       |                          |                                    |                          |                                  |
| Donations and Forfeitures of Property                     | 6                        | -                                  | 6                        |                                  |
| Transfers in/out reimbursement                            | 30                       | -                                  | 30                       |                                  |
| Imputed Financing   | 702                      | -                                  | 702                      |                                  |
| Total Financing Sources                                   | 56,409                   | (39)                               | 56,370                   |                                  |
| Net Cost of Operations                                    | (54,318)                 | 127                                | (54,191)                 | A, B, C, D                       |
| Net Change  | <b>2,091</b>             | <b>88</b>                          | <b>2,179</b>             |                                  |
| <b>Cumulative Results of Operations</b>                   | <b>\$(39,756)</b>        | <b>\$(500)</b>                     | <b>\$(40,256)</b>        |                                  |
| <b>Unexpended Appropriations:</b>                         |                          |                                    |                          |                                  |
| Beginning Balance   | \$87,131                 | \$ -                               | \$87,131                 |                                  |
| Adjustments:  |                          |                                    |                          |                                  |
| Corrections of errors                                     | -                        | 676                                | 676                      | A, B                             |
| Beginning Balance, as adjusted                            | <b>\$87,131</b>          | <b>\$676</b>                       | <b>\$87,807</b>          |                                  |
| <b>Budgetary Financing Sources:</b>                       |                          |                                    |                          |                                  |
| Appropriations Received                                   | \$39,529                 | \$ -                               | \$39,529                 |                                  |
| Appropriations transferred in/out                         | (573)                    | -                                  | (573)                    |                                  |
| Other Adjustments   | (25,090)                 | 15                                 | (25,075)                 | B, D                             |
| Appropriations Used                                       | (52,895)                 | 23                                 | (52,872)                 | A, B, D                          |
| Total Budgetary Financing Sources                         | (39,029)                 | 38                                 | (38,991)                 |                                  |
| Total Unexpended Appropriations                           | <b>48,102</b>            | <b>714</b>                         | <b>48,816</b>            |                                  |
| <b>NET POSITION</b>                                       | <b>\$8,346</b>           | <b>\$214</b>                       | <b>\$8,560</b>           |                                  |

| STATEMENT OF BUDGETARY<br>RESOURCES, in millions          | Original 2006    |  | Effects of Restatements |  | Restated 2006    |  | Description<br>Reference |
|---|------------------|--|-------------------------|--|------------------|--|--------------------------|
|   | Budgetary        | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts | Budgetary               | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts | Budgetary        | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts |                          |
| <b>BUDGETARY RESOURCES</b>                                |                  |  |                         |  |                  |  |                          |
| Unobligated Balance, brought forward<br>October 1         | \$56,879         | \$26   | \$26                    | \$ -   | \$56,905         | \$26   | B                        |
| Recoveries of Prior Year Unpaid<br>Obligations            | 3,654            | -  | 86                      | -  | 3,740            | -  | B                        |
| Budget Authority:   |                  |  |                         |  |                  |  |                          |
| Appropriations  | 45,748           | -  | -                       | -  | 45,748           | -  |                          |
| Borrowing Authority                                       | 17,500           | 629  | -                       | -  | 17,500           | 629  |                          |
| Earned:   |                  |  |                         |  |                  |  |                          |
| Collected   | 9,092            | 478  | 1                       | -  | 9,093            | 478  | B                        |
| Change in Receivable from Federal<br>Sources              | 39               | -  | (1)                     | -  | 38               | -  | A                        |
| Change in Unfilled Customer Orders:                       |                  |  |                         |  |                  |  |                          |
| Advance Received  | (541)            | -  | -                       | -  | (541)            | -  |                          |
| Without Advance From Federal<br>Sources                   | 186              | 481  | -                       | -  | 186              | 481  |                          |
| Expenditure transfers from trust funds                    | 49               | -  | -                       | -  | 49               | -  |                          |
| Subtotal  | 72,073           | 1,588  | -                       | -  | 72,073           | 1,588  |                          |
| Non-expenditure transfers, net; anticipated<br>and actual | (228)            | -  | -                       | -  | (228)            | -  |                          |
| Temporarily Not Available Pursuant to<br>Public Law       | (29)             | -  | 5                       | -  | (24)             | -  | B                        |
| Permanently Not Available                                 | (25,173)         | (334)  | 1                       | -  | (25,172)         | (334)  | D                        |
| <b>TOTAL BUDGETARY RESOURCES</b>                          | <b>\$107,176</b> | <b>\$1,280</b>   | <b>\$118</b>            | <b>-</b>   | <b>\$107,294</b> | <b>\$1,280</b>   |                          |



|  | Original 2006                                  |                 | Effects of Restatements                        |                 | Restated 2006                                  |                 |                  |
|--|--|-----------------|--|-----------------|--|-----------------|------------------|
|  | Non-Budgetary Credit Reform Financing Accounts |                 | Non-Budgetary Credit Reform Financing Accounts |                 | Non-Budgetary Credit Reform Financing Accounts |                 | Description      |
| <b>STATEMENT OF BUDGETARY RESOURCES, in millions</b> | <b>Budgetary</b>                               | <b>Accounts</b> | <b>Budgetary</b>                               | <b>Accounts</b> | <b>Budgetary</b>                               | <b>Accounts</b> | <b>Reference</b> |
| <b>STATUS OF BUDGETARY RESOURCES</b>                 |  |                 |  |                 |  |                 |                  |
| Obligations Incurred:                                |  |                 |  |                 |  |                 |                  |
| Direct   | \$85,843                                       | \$1,280         | \$(340)  | -               | \$85,503                                       | \$1,280         | A, B             |
| Reimbursable   | 4,289  | -               | 198  | -               | 4,487  | -               | B                |
| Subtotal   | <b>90,132</b>                                  | <b>1,280</b>    | <b>(142)</b>                                   | <b>-</b>        | <b>89,990</b>                                  | <b>1,280</b>    |                  |
| Unobligated Balance:                                 |  |                 |  |                 |  |                 |                  |
| Apportioned  | 11,365   | -               | 489  | -               | 11,854   | -               | A, B, D          |
| Exempt from Apportionment                            | 80   | -               | -  | -               | 80   | -               |                  |
| Subtotal   | <b>11,445</b>                                  | <b>-</b>        | <b>489</b>                                     | <b>-</b>        | <b>11,934</b>                                  | <b>-</b>        |                  |
| Unobligated Balance Not Available                    | 5,599  | -               | (229)  | -               | 5,370  | -               | A, B, D          |
| <b>TOTAL STATUS OF BUDGETARY RESOURCES</b>           | <b>\$107,176</b>                               | <b>\$1,280</b>  | <b>\$118</b>                                   | <b>\$ -</b>     | <b>\$107,294</b>                               | <b>\$1,280</b>  |                  |

|   | Original 2006 |  | Effects of Restatements |  | Restated 2006 |  |             |
|---|---------------|--|-------------------------|--|---------------|--|-------------|
|   |               | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts |                         | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts |               | Non-<br>Budgetary<br>Credit<br>Reform<br>Financing<br>Accounts | Description |
| STATEMENT OF BUDGETARY<br>RESOUCES, in millions   | Budgetary     |  | Budgetary               |  | Budgetary     |  | Reference   |
| CHANGE IN OBLIGATED BALANCE   |               |  |                         |  |               |  |             |
| Obligated Balance, Net  |               |  |                         |  |               |  |             |
| Unpaid obligations brought forward, October 1   | \$40,456      | \$ -   | \$(26)                  | \$ -   | \$40,430      | \$ -   | B           |
| Less: Uncollected customer payments from<br>Federal Sources, brought forward, October 1 | (1,845)       | -  | -                       | -  | (1,845)       | -  |             |
| Total unpaid obligated balance, net   | 38,611        | -  | (26)                    | -  | 38,585        | -  |             |
| Obligations incurred, net   | 90,132        | 1,280  | (142)                   | -  | 89,990        | 1,280  | A, B        |
| Less: Gross Outlays   | (83,674)      | (639)  | (1)                     | -  | (83,675)      | (639)  | A, B        |
| Obligated balance transferred, net  |               |  |                         |  |               |  |             |
| Actual transfers, unpaid obligations  | -             | -  | -                       | -  | -             | -  |             |
| Total unpaid obligated balance transferred, net   | -             | -  | -                       | -  | -             | -  |             |
| Recoveries of Prior Year Unpaid Obligations,<br>Actual                                  | (3,654)       | -  | (86)                    | -  | (3,740)       | -  | B           |
| Change in uncollected customer payments from<br>Federal Sources                         | (225)         | (481)  | 1                       | -  | (224)         | (481)  | A           |
| Obligated balance, net end of period  |               |  |                         |  |               |  |             |
| Unpaid obligations  | 43,260        | 642  | (255)                   | -  | 43,005        | 642  | A, B        |
| Less: Uncollected customer payments from<br>Federal Sources                             | (2,070)       | (482)  | 1                       | -  | (2,069)       | (482)  | A           |
| Total, unpaid obligated balance, net end of period                                      | 41,190        | 160  | (254)                   | -  | 40,936        | 160  |             |
| Net Outlays   |               |  |                         |  |               |  |             |
| Gross Outlays   | 83,674        | 639  | 1                       | -  | 83,675        | 639  | A, B        |
| Less: Offsetting Collections  | (8,600)       | (478)  | (1)                     | -  | (8,601)       | (478)  | B           |
| Less: Distributed Offsetting Receipts   | (4,821)       | -  | -                       | -  | (4,821)       | -  |             |
| NET OUTLAYS   | \$70,253      | \$161  | \$ -                    | \$-  | \$70,253      | \$161  |             |

### 35. Reconciliation of Net Cost of Operations (Proprietary) to Budget (Formerly the Statement of Financing)

The Reconciliation of Net Cost of Operations to Budget reconciles the Department's *Resources Used to Finance Activities* (first section), which consists of the budgetary basis of accounting Net Obligations plus the proprietary basis of accounting Other Resources, to the proprietary basis of accounting Net Cost of Operations. The second section, *Resources Used to Finance Items Not Part of Net Cost of Operations*, reverses out items included in the first section that are not included in Net Cost of Operations. The third section, *Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period*, adds items included in the Net Cost of Operations that are not included in the first section.

The third section's subsection, Components Requiring or Generating Resources in Future Periods, includes costs reported in the current period that are included in the Liabilities Not Covered by Budgetary Resources reported in Note 14. This subsection does not include costs reported in prior fiscal years that are also included in Liabilities Not Covered by Budgetary Resources.

In accordance with Revised OMB Circular No. A-136, *Financial Reporting Requirements*, dated June 29, 2007, the Statement of Financing is presented as a footnote disclosure and is no longer a basic financial statement, as had been presented in prior years. The information provided in the FY 2006 Statement of Financing is also presented in this footnote, to provide comparative disclosures, as required. The reconciliation of net cost of operations to budget for FY 2007 and FY 2006 is as follows:

|   | <u>2007</u><br>(Unaudited) | <u>2006</u><br>(Unaudited)<br>(Restated) |
|---|----------------------------|--|
| <b>Resources Used to Finance Activities</b>   |                            |  |
| <b>Budgetary Resources Obligated</b>  |                            |  |
| Obligations Incurred (Note 25)  | \$62,002                   | \$91,270                                 |
| Less: Spending Authority from Offsetting Collections and Recoveries                                   | (15,942)                   | (13,524)                                 |
| Obligations Net of Offsetting Collections and Recoveries  | 46,060                     | 77,746                                   |
| Less: Offsetting Receipts   | (4,952)                    | (4,821)                                  |
| Net Obligations   | 41,108                     | 72,925                                   |
| <b>Other Resources</b>  |                            |  |
| Donations and Forfeiture of Property  | 4                          | 6  |
| Transfers in (out) Without Reimbursement  | 9                          | 30                                       |
| Imputed Financing from Costs Absorbed by Others   | 839                        | 702                                      |
| Net Other Resources Used to Finance Activities  | 852                        | 738                                      |
| <b>Total Resources Used to Finance Activities</b>   | <b>\$41,960</b>            | <b>\$73,663</b>                          |
| <b>Resources Used to Finance Items Not Part of the Net Cost of Operations</b>                         |                            |  |
| Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided | \$512                      | \$1,976                                  |

|   |                 |                 |
|---|-----------------|-----------------|
| Resources that Fund Expenses Recognized in Prior Periods  | (1,500)         | 19,576          |
| Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations:                            |                 |                 |
| Credit program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy                  | 336             | (478)           |
| Other   | (2,354)         | (2,433)         |
| Resources that Finance the Acquisition of Assets  | 2,925           | 2,681           |
| Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations                 | 1,733           | 1,669           |
| <b>Total Resources Used to Finance Items Not Part of the Net Cost of Operations</b>                                 | <b>1,652</b>    | <b>22,991</b>   |
| <b>TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS</b>   | <b>\$40,308</b> | <b>\$50,672</b> |
| <br>  |                 |                 |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>  |                 |                 |
| <b>Components Requiring or Generating Resources in Future Periods</b>   |                 |                 |
| Increase in Annual Leave Liability  | \$85            | \$140           |
| Increase in Environmental and Disposal Liability  | 34              | 66              |
| Increase in Exchange Revenue Receivable from the Public   | (1)             | (182)           |
| Other   |                 |                 |
| Increase in Insurance Liabilities   | 3               | -               |
| Increase in Actuarial Pension Liability   | 2,200           | 1,721           |
| Increase in USCG Military Post Employment Benefits  | 6               | 37              |
| Increase in Actuarial Health Insurance Liability  | 265             | 658             |
| Other   | (1,768)         | 366             |
| Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods                | 824             | 2,806           |
| <b>Components not Requiring or Generating Resources</b>   |                 |                 |
| Depreciation and Amortization   | 1,130           | 1,157           |
| Revaluation of Assets or Liabilities  | 65              | (72)            |
| Other   | 488             | (372)           |
| Total Components of Net Cost of Operations that will not Require or Generate Resources                              | 1,683           | 713             |
| <b>Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period</b> | <b>2,507</b>    | <b>3,519</b>    |
| <b>NET COST OF OPERATIONS</b>   | <b>\$42,815</b> | <b>\$54,191</b> |

### **36. Explanation for Change in Accounting Method on the Statement of Changes in Net Position**

Effective October 1, 2006, DHS adopted the reporting provisions of trust funds with multiple program agencies. This change was a result of clarifying language on mixed fund reporting added to OMB Circular A-136. Under this accounting method, DHS will report TAFS 20X8147 Bureau of Public Debt (BPD) Trust Fund account balance and transaction activity for the Sport Fish Restoration Boating Trust Fund (SFRBTF). OMB Circular A-136 requires that DHS report this trust fund since the USCG is the agency that reports the trust fund activity in the President's Budget, and to which funds are appropriated for distribution to other program agencies.

In accordance with OMB Circular A-136, DHS applied the reporting provisions trust funds prospectively beginning in FY 2007. To initially record the SFRBTF balance DHS recorded assets, including fund balance with Treasury and investments totaling approximately \$1.7 billion, and offsetting liabilities to other program agencies totaling approximately \$1 billion. In addition, the change in accounting for the SFRBTF required an adjustment to beginning of the year cumulative results of operations totaling \$693 million, as shown on the statement of Statement of Changes in Net Position. The SFRBTF is considered an earmarked fund and accordingly significant account balances and activity is reported in Note 22.

### **37. Explanation for Difference between the Current Year Beginning Balances and the Prior Year Ending Balances**

DHS Current Year Beginning Balances and Prior Year Ending Balances have differences due to reinstatement of a TAFS at FEMA. The TAFS was reinstated in accordance with *P.L. 109-295, Section 542, Authorizes Disaster Assistance for Unmet Needs* funds provided to the City of Cuero, TX to be available for use until September 30, 2007. However, this public law was approved after FY 2006 financial reporting. In December 2006, FEMA, working with Financial Management Services, had the TAFS reinstated and the period of availability extended. Consequently, these funds were not legally available to be included in the Prior Year Ending Balances. Therefore, the Statement of Budgetary Resources has differences for the current year and prior year balances for Unobligated Balances Brought Forward of \$9 million, Unpaid Obligations of \$31 million, and Total Unpaid Obligations of \$31 million.

Further, the current year beginning balance was adjusted for the Statement of Changes in Net Position, Unexpended Appropriations for \$37 million.

## Required Supplementary Information (Unaudited, see Auditors' Report)

### 1. Stewardship PP&E

#### Heritage Assets

USCG and CBP maintain Heritage Assets, located in the United States, including the Commonwealth of Puerto Rico. Heritage Assets are property, plant, and equipment that have historical or national significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage Assets are generally expected to be preserved indefinitely. Multi-use Heritage Assets have more than one purpose such as an operational purpose and historical purpose.

The following table summarizes activity related to Heritage Assets for the fiscal years ended September 30 (in number of units).

| 2007 (Unaudited)      | USCG          | CBP      | FEMA     | Total         |
|-----------------------|---------------|----------|----------|---------------|
| Beginning Balance     | 20,425        | 4        | 1        | 20,430        |
| Additions             | 278           | -        | -        | 278           |
| Withdrawals           | (154)         | -        | -        | (154)         |
| <b>Ending Balance</b> | <b>20,549</b> | <b>4</b> | <b>1</b> | <b>20,554</b> |

| 2006 (Unaudited)<br>(Restated) | USCG          | CBP      | FEMA     | Total         |
|--------------------------------|---------------|----------|----------|---------------|
| Beginning Balance              | 20,254        | 4        | 1        | 20,259        |
| Additions                      | 349           | -        | -        | 349           |
| Withdrawals                    | (178)         | -        | -        | (178)         |
| <b>Ending Balance</b>          | <b>20,425</b> | <b>4</b> | <b>1</b> | <b>20,430</b> |

USCG possesses artifacts that can be divided into four general areas: ship's equipment, lighthouse and other aids-to-navigation items, military uniforms, and display models. Historical artifacts are also gifted to USCG. Withdrawals are made when items have deteriorated through inappropriate display, damage due to moving and transportation, or environmental degradation.

- Ship's equipment is generally acquired when the ship is decommissioned and includes small items such as sextants, ship's clocks, wall plaques, steering wheels, bells, binnacles,

engine order telegraphs, and ship's name boards. Conditions will vary based upon use and age.

- Aids-to-navigation items include fog and buoy bells, lanterns, lamp changing apparatus, and lighthouse lenses. Buoy equipment is usually acquired when new technology renders the equipment obsolete. Classical lighthouse lenses can vary in condition. The condition is normally dependent on how long the item has been out of service. The lenses go to local museums or USCG bases as display items.
- Military uniforms are generally donated by retired USCG members and include clothing, as well as insignia and accessories. Most clothing is in fair to good condition, particularly full dress items.
- Display models are mostly of USCG vessels and aircraft. These are often builders' models. Display models are generally in very good condition. Builders' models are acquired by USCG as part of the contracts with the ship or aircraft builders. The withdrawal of display models normally results from excessive wear.

USCG also has non-collection type Heritage Assets, such as sunken vessels and aircraft, under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain government-owned until the Congress of the United States formally declares them abandoned. USCG desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of USCG's long and rich tradition of service to our Nation in harm's way.

**Buildings and Structures** – USCG does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of USCG buildings and structures designated as Heritage, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use Heritage. The remaining assets are historical lighthouses, which are no longer in use and awaiting disposal; their related assets; and a gravesite.

CBP also has four multi-use Heritage Assets located in Puerto Rico, and FEMA has one multi-use Heritage Asset that is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. All multi-use Heritage Assets are reflected on the Balance Sheet and related footnotes. Deferred maintenance information for Heritage Assets and general PP&E is presented in the required supplementary information.

## **2. Deferred Maintenance**

The Department Components use condition assessment as the method for determining the deferred maintenance for each class of asset. The procedure includes reviewing equipment, building, and other structure logistic reports. Component logistic personnel identify maintenance not performed as scheduled and establish future performance dates. Logistic personnel use a condition

assessment survey to determine the status of referenced assets according to the range of conditions shown below:

**Good.** Facility/equipment condition meets established maintenance standards, operates efficiently, and has a normal life expectancy. Scheduled maintenance should be sufficient to maintain the current condition. There is no deferred maintenance on buildings or equipment in good condition.

**Fair.** Facility/equipment condition meets minimum standards but requires additional maintenance or repair to prevent further deterioration, increase operating efficiency, and to achieve normal life expectancy.

**Poor.** Facility/equipment does not meet most maintenance standards and requires frequent repairs to prevent accelerated deterioration and provide a minimal level of operating function. In some cases, this includes condemned or failed facilities. Based on periodic condition assessments, an indicator of condition is the percent of facilities and item of equipment in each of the good, fair, or poor categories.

Deferred maintenance as of September 30, 2007, was estimated to range from \$777 million to \$1,064 million on general property, plant, and equipment and Heritage Assets with a range of poor to good condition. In FY 2006, the Department reported estimated deferred maintenance of \$771 million to \$967 million with a range of poor to good condition. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be and which is delayed for a future period.

A summary of deferred maintenance at September 30, 2007, is presented below (in millions):

|                                  | <b>Low<br/>estimate</b> | <b>High<br/>estimate</b> | <b>Asset Condition</b> |
|----------------------------------|-------------------------|--------------------------|------------------------|
| Building & Structures            | \$573                   | \$814                    | Good to Poor           |
| Equipment (vehicles and vessels) | 204                     | 249                      | Good to Fair           |
| Heritage assets                  | -                       | 1                        | Fair                   |
| <b>Total</b>                     | <b>\$777</b>            | <b>\$1,064</b>           |                        |



### 3. Statement of Budgetary Resources

#### Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 1 of 2)

|  | CBP             | USCG            | USCIS          | FEMA            | FLETC        | ICE            | OHA            | DeptOps        | NPPD           | USSS           | S&T            | TSA            | TOTAL           |
|--|-----------------|-----------------|----------------|-----------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------|
| <b>BUDGETARY RESOURCES</b>                             |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Unobligated balance, brought forward, Oct 1            | \$2,297         | \$1,881         | \$419          | \$9,166         | \$90         | \$654          | \$1,468        | \$218          | \$279          | \$56           | \$408          | \$377          | <b>\$17,313</b> |
| Recoveries of Prior Year Obligations                   | 199             | -               | 59             | 3,022           | 14           | 215            | 915            | 42             | 47             | 14             | 70             | 341            | <b>4,938</b>    |
| Budget Authority:                                      |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Appropriations   | 11,191          | 8,551           | 2,323          | 10,700          | 275          | 4,209          | 8              | 1,636          | 965            | 1,494          | 978            | 4,161          | <b>46,491</b>   |
| Spending Authority from Offsetting Collections:        |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Earned:  |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Collected  | 1,514           | 575             | 35             | 3,803           | 136          | 1,141          | -              | 400            | -              | 23             | 35             | 2,637          | <b>10,299</b>   |
| Change in Receivable from Federal Sources              | (34)            | (11)            | 2              | 9               | 9            | (8)            | -              | 25             | -              | 2              | 2              | (1)            | <b>(5)</b>      |
| Change in Unfilled Customer Orders:                    |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Advance Received                                       | (3)             | 38              | -              | 42              | -            | (1)            | -              | -              | 2              | (6)            | 1              | 5              | <b>78</b>       |
| Without Advance From Federal Sources                   | (20)            | (8)             | (14)           | 669             | (28)         | (45)           | 1              | 52             | 1              | (4)            | (2)            | (17)           | <b>585</b>      |
| Previously Unavailable                                 | -               | -               | -              | (1)             | -            | -              | -              | -              | -              | -              | -              | -              | <b>(1)</b>      |
| Expenditure transfers from trust funds                 | 3               | 45              | -              | -               | -            | -              | -              | -              | -              | -              | -              | -              | <b>48</b>       |
| Subtotal   | 12,651          | 9,190           | 2,346          | 15,222          | 392          | 5,296          | 9              | 2,113          | 968            | 1,509          | 1,014          | 6,785          | <b>57,495</b>   |
| Non-expenditure transfers, net; anticipated and actual | 373             | 323             | -              | 67              | -            | (8)            | 17             | 6              | (4)            | 8              | -              | 5              | <b>787</b>      |
| Temporarily Not Available Pursuant to Public Law       | -               | -               | -              | -               | -            | -              | -              | -              | -              | -              | -              | -              | <b>-</b>        |
| Permanently Not Available                              | (102)           | (222)           | (12)           | (135)           | (3)          | (28)           | -              | (18)           | (5)            | (21)           | (128)          | (67)           | <b>(741)</b>    |
| <b>TOTAL BUDGETARY RESOURCES</b>                       | <b>\$15,418</b> | <b>\$11,172</b> | <b>\$2,812</b> | <b>\$27,342</b> | <b>\$493</b> | <b>\$6,129</b> | <b>\$2,409</b> | <b>\$2,361</b> | <b>\$1,285</b> | <b>\$1,566</b> | <b>\$1,364</b> | <b>\$7,441</b> | <b>\$79,792</b> |
| <b>STATUS OF BUDGETARY RESOURCES</b>                   |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Obligations Incurred:                                  |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Direct   | \$11,036        | \$8,956         | \$1,939        | \$17,308        | \$289        | \$4,560        | \$966          | \$1,467        | \$908          | \$1,468        | \$1,045        | \$6,740        | <b>\$56,682</b> |
| Reimbursable   | 1,487           | 551             | 28             | 1,552           | 123          | 1,066          | -              | 462            | 1              | 16             | 24             | 10             | <b>5,320</b>    |
| Subtotal   | 12,523          | 9,507           | 1,967          | 18,860          | 412          | \$5,626        | 966            | 1,929          | 909            | 1,484          | 1,069          | 6,750          | <b>62,002</b>   |
| Unobligated Balance:                                   |                 |                 |                |                 |              |                |                |                |                |                |                |                |                 |
| Apportioned  | 17              | 923             | 233            | 5,999           | 64           | 300            | 528            | 336            | 170            | 47             | 291            | 245            | <b>9,153</b>    |
| Exempt from Apportionment                              | -               | 92              | -              | 5               | -            | -              | -              | -              | -              | -              | -              | -              | <b>97</b>       |
| Subtotal   | 17              | 1,015           | 233            | 6,004           | 64           | 300            | 528            | 336            | 170            | 47             | 291            | 245            | <b>9,250</b>    |
| Unobligated Balance Not Available                      | 2,878           | 650             | 612            | 2,478           | 17           | 203            | 915            | 96             | 206            | 35             | 4              | 446            | <b>8,540</b>    |
| <b>TOTAL STATUS OF BUDGETARY RESOURCES</b>             | <b>\$15,418</b> | <b>\$11,172</b> | <b>\$2,812</b> | <b>\$27,342</b> | <b>\$493</b> | <b>\$6,129</b> | <b>\$2,409</b> | <b>\$2,361</b> | <b>\$1,285</b> | <b>\$1,566</b> | <b>\$1,364</b> | <b>\$7,441</b> | <b>\$79,792</b> |

**Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 2 of 2)**

|  | CBP            | USCG           | USCIS          | FEMA            | FLETC        | ICE            | OHA        | DeptOps      | NPPD         | USSS           | S&T            | TSA            | TOTAL           |
|--|----------------|----------------|----------------|-----------------|--------------|----------------|------------|--------------|--------------|----------------|----------------|----------------|-----------------|
| <b>CHANGE IN OBLIGATED BALANCES</b>  |                |                |                |                 |              |                |            |              |              |                |                |                |                 |
| Obligated Balance, Net   |                |                |                |                 |              |                |            |              |              |                |                |                |                 |
| Unpaid obligations brought forward, Oct 1                                  | \$3,067        | \$3,144        | \$640          | \$27,673        | \$265        | \$1,649        | \$1,802    | \$758        | \$773        | \$307          | \$1,256        | \$2,344        | <b>\$43,678</b> |
| Uncollected customer payments from federal sources, brought forward, Oct 1 | (375)          | (233)          | (25)           | (981)           | (153)        | (484)          | -          | (175)        | (1)          | (21)           | (34)           | (69)           | <b>(2,551)</b>  |
| Total unpaid obligated balance, net  | 2,692          | 2,911          | 615            | 26,692          | 112          | 1,165          | 1,802      | 583          | 772          | 286            | 1,222          | 2,275          | <b>41,127</b>   |
| Obligations incurred, net  | 12,523         | 9,507          | 1,967          | 18,860          | 412          | 5,626          | 966        | 1,929        | 909          | 1,484          | 1,069          | 6,750          | <b>62,002</b>   |
| Gross Outlays  | (11,356)       | (8,839)        | (1,814)        | (18,208)        | (443)        | (4,889)        | (3)        | (1,348)      | (926)        | (1,444)        | (1,153)        | (6,045)        | <b>(56,468)</b> |
| Obligated balance transferred, net   | 34             | -              | (34)           | (18)            | -            | -              | 15         | 2            | (12)         | -              | (5)            | -              | <b>(18)</b>     |
| Recoveries of Prior Year Unpaid Obligations                                | (199)          | -              | (59)           | (3,022)         | (14)         | (215)          | (915)      | (42)         | (47)         | (14)           | (70)           | (341)          | <b>(4,938)</b>  |
| Change in uncollected customer payments from Federal Sources               | 55             | 20             | 12             | (679)           | 19           | 54             | -          | (81)         | (1)          | 2              | -              | 18             | <b>(581)</b>    |
| Obligated balance, net end of Period                                       |                |                |                |                 |              |                |            |              |              |                |                |                |                 |
| Unpaid Obligations   | 4,070          | 3,813          | 700            | 25,285          | 220          | 2,172          | 1,865      | 1,296        | 697          | 333            | 1,097          | 2,707          | <b>44,255</b>   |
| Uncollected customer payments from Federal Sources                         | (321)          | (214)          | (13)           | (1,660)         | (134)        | (431)          | -          | (253)        | (2)          | (19)           | (34)           | (50)           | <b>(3,131)</b>  |
| Total, unpaid obligated balance, net, end of period                        | 3,749          | 3,599          | 687            | 23,625          | 86           | 1,741          | 1,865      | 1,043        | 695          | 314            | 1,063          | 2,657          | <b>41,124</b>   |
| <b>NET OUTLAYS</b>   |                |                |                |                 |              |                |            |              |              |                |                |                |                 |
| Net Outlays  |                |                |                |                 |              |                |            |              |              |                |                |                |                 |
| Gross Outlays  | 11,356         | 8,839          | 1,814          | 18,208          | 443          | 4,889          | 3          | 1,348        | 926          | 1,444          | 1,153          | 6,045          | <b>56,468</b>   |
| Offsetting collections   | (1,515)        | (657)          | (35)           | (3,846)         | (135)        | (1,140)        | -          | (400)        | (2)          | (18)           | (36)           | (2,642)        | <b>(10,426)</b> |
| Distributed offsetting receipts  | (2,361)        | (23)           | (2,080)        | (61)            | (1)          | (155)          | (1)        | 2            | -            | -              | 1              | (273)          | <b>(4,952)</b>  |
| <b>Net Outlays</b>   | <b>\$7,480</b> | <b>\$8,159</b> | <b>\$(301)</b> | <b>\$14,301</b> | <b>\$307</b> | <b>\$3,594</b> | <b>\$2</b> | <b>\$950</b> | <b>\$924</b> | <b>\$1,426</b> | <b>\$1,118</b> | <b>\$3,130</b> | <b>\$41,090</b> |

**Schedule of FY 2006 Budgetary Resources by Responsibility Segments (in millions) (Restated) (page 1 of 2)**

|  | CBP             | USCG            | USCIS          | FEMA            | FLETC        | ICE            | OHA            | DeptOps        | NPPD           | USSS           | S&T            | TSA            | TOTAL            |
|--|-----------------|-----------------|----------------|-----------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| <b>BUDGETARY RESOURCES</b>                       |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Unobligated balance, brought forward, October 1  | \$1,724         | \$1,254         | \$318          | \$49,285        | \$76         | \$425          | \$2,324        | \$170          | \$284          | \$79           | \$276          | \$716          | <b>\$56,931</b>  |
| Recoveries of Prior Year Obligations             | 217             | -               | 155            | 2,565           | 55           | 348            | -              | 43             | 44             | -              | 179            | 134            | <b>3,740</b>     |
| Budget Authority:                                |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Appropriations                                   | 9,254           | 8,762           | 1,813          | 12,556          | 308          | 3,743          | -              | 960            | 982            | 1,436          | 1,502          | 4,432          | <b>45,748</b>    |
| Borrowing Authority                              | -               | -               | -              | 18,129          | -            | -              | -              | -              | -              | -              | -              | -              | <b>18,129</b>    |
| Spending Authority from Offsetting Collections:  |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Earned:  |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Collected  | 1,291           | 561             | 25             | 3,912           | 87           | 1,271          | -              | 426            | 9              | 18             | 10             | 1,961          | <b>9,571</b>     |
| Change in Receivable from Federal Sources        | 9               | 18              | 1              | 2               | 2            | 3              | -              | (1)            | -              | 3              | 2              | (1)            | <b>38</b>        |
| Change in Unfilled Customer Orders:              |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Advance Received                                 | 1               | 30              | (5)            | (524)           | -            | (14)           | -              | -              | -              | (2)            | (18)           | (9)            | <b>(541)</b>     |
| Without Advance From Federal Sources             | 42              | 33              | 13             | 441             | 109          | (2)            | -              | (6)            | (5)            | 9              | 32             | 1              | <b>667</b>       |
| Expenditure transfers from trust funds           | 3               | 46              | -              | -               | -            | -              | -              | -              | -              | -              | -              | -              | <b>49</b>        |
| Subtotal   | 10,600          | 9,450           | 1,847          | 34,516          | 506          | 5,001          | -              | 1,379          | 986            | 1,464          | 1,528          | 6,384          | <b>73,661</b>    |
| Non-expenditure transfers, net; anticipated and  | 244             | 280             | -              | (750)           | -            | 16             | -              | (4)            | -              | -              | (14)           | -              | <b>(228)</b>     |
| Temporarily Not Available Pursuant to Public Law | -               | -               | -              | (24)            | -            | -              | -              | -              | -              | -              | -              | -              | <b>(24)</b>      |
| Permanently Not Available                        | (160)           | (485)           | (11)           | (23,865)        | (7)          | (39)           | -              | (35)           | (25)           | (49)           | (35)           | (795)          | <b>(25,506)</b>  |
| <b>TOTAL BUDGETARY RESOURCES</b>                 | <b>\$12,625</b> | <b>\$10,499</b> | <b>\$2,309</b> | <b>\$61,727</b> | <b>\$630</b> | <b>\$5,751</b> | <b>\$2,324</b> | <b>\$1,553</b> | <b>\$1,289</b> | <b>\$1,494</b> | <b>\$1,934</b> | <b>\$6,439</b> | <b>\$108,574</b> |
| <b>STATUS OF BUDGETARY RESOURCES</b>             |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Obligations Incurred:                            |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Direct   | \$9,033         | \$8,027         | \$1,868        | \$52,033        | \$308        | \$3,826        | \$856          | \$906          | \$1,008        | \$1,409        | \$1,491        | \$6,018        | <b>\$86,783</b>  |
| Reimbursable                                     | 1,295           | 591             | 22             | 535             | 233          | 1,275          | -              | 428            | 2              | 29             | 35             | 42             | <b>4,487</b>     |
| Subtotal   | 10,328          | 8,618           | 1,890          | 52,568          | 541          | 5,101          | 856            | 1,334          | 1,010          | 1,438          | 1,526          | 6,060          | <b>91,270</b>    |
| Unobligated Balance:                             |                 |                 |                |                 |              |                |                |                |                |                |                |                |                  |
| Apportioned                                      | 293             | 1,271           | 107            | 7,001           | 73           | 275            | 1,468          | 161            | 246            | 5              | 404            | 550            | <b>11,854</b>    |
| Exempt from Apportionment                        | -               | 66              | -              | 14              | -            | -              | -              | -              | -              | -              | -              | -              | <b>80</b>        |
| Subtotal   | 293             | 1,337           | 107            | 7,015           | 73           | 275            | 1,468          | 161            | 246            | 5              | 404            | 550            | <b>11,934</b>    |
| Unobligated Balance Not Available                | 2,004           | 544             | 312            | 2,144           | 16           | 375            | -              | 58             | 33             | 51             | 4              | (171)          | <b>5,370</b>     |
| <b>TOTAL STATUS OF BUDGETARY RESOURCES</b>       | <b>\$12,625</b> | <b>\$10,499</b> | <b>\$2,309</b> | <b>\$61,727</b> | <b>\$630</b> | <b>\$5,751</b> | <b>\$2,324</b> | <b>\$1,553</b> | <b>\$1,289</b> | <b>\$1,494</b> | <b>\$1,934</b> | <b>\$6,439</b> | <b>\$108,574</b> |

**Schedule of FY 2006 Budgetary Resources by Responsibility Segments (in millions) (Restated) (page 2 of 2)**

|  | <b>CBP</b>     | <b>USCG</b>    | <b>USCIS</b>   | <b>FEMA</b>     | <b>FLETC</b> | <b>ICE</b>     | <b>OHA</b>  | <b>DeptOps</b> | <b>NPPD</b>    | <b>USSS</b>    | <b>S&amp;T</b> | <b>TSA</b>     | <b>TOTAL</b>    |
|--|----------------|----------------|----------------|-----------------|--------------|----------------|-------------|----------------|----------------|----------------|----------------|----------------|-----------------|
| <b>CHANGE IN OBLIGATED BALANCES</b>  |                |                |                |                 |              |                |             |                |                |                |                |                |                 |
| Obligated Balance, Net   |                |                |                |                 |              |                |             |                |                |                |                |                |                 |
| Unpaid obligations brought forward, October 1                                  | \$2,398        | \$3,061        | \$636          | \$27,010        | \$114        | \$1,273        | \$999       | \$550          | \$915          | \$243          | \$952          | \$2,279        | <b>\$40,430</b> |
| Uncollected customer payments from federal sources, brought forward, October 1 | (323)          | (182)          | (11)           | (538)           | (42)         | (483)          | -           | (182)          | (6)            | (9)            | -              | (69)           | <b>(1,845)</b>  |
| Total unpaid obligated balance, net  | 2,075          | 2,879          | 625            | 26,472          | 72           | 790            | 999         | 368            | 909            | 234            | 952            | 2,210          | <b>38,585</b>   |
| Obligations incurred, net  | 10,328         | 8,618          | 1,890          | 52,568          | 541          | 5,101          | 856         | 1,334          | 1,010          | 1,438          | 1,526          | 6,060          | <b>91,270</b>   |
| Gross Outlays  | (9,441)        | (8,535)        | (1,731)        | (49,372)        | (335)        | (4,372)        | (53)        | (1,084)        | (1,107)        | (1,374)        | (1,044)        | (5,866)        | <b>(84,314)</b> |
| Recoveries of Prior Year Unpaid Obligations                                    | (218)          | -              | (156)          | (2,565)         | (55)         | (348)          | -           | (43)           | (43)           | -              | (178)          | (134)          | <b>(3,740)</b>  |
| Change in uncollected customer payments from Federal Sources                   | (52)           | (51)           | (14)           | (443)           | (111)        |                | -           | 7              | 5              | (12)           | (34)           | -              | <b>(705)</b>    |
| Obligated balance, net end of Period   |                |                |                |                 |              |                |             |                |                |                |                |                |                 |
| Unpaid Obligations   | 3,067          | 3,144          | 639            | 27,642          | 265          | 1,654          | 1,802       | 757            | 775            | 307            | 1,256          | 2,339          | <b>43,647</b>   |
| Uncollected customer payments from Federal Sources                             | (375)          | (233)          | (25)           | (982)           | (153)        | (483)          | -           | (175)          | (1)            | (21)           | (34)           | (69)           | <b>(2,551)</b>  |
| Total, unpaid obligated balance, net, end of period                            | 2,692          | 2,911          | 614            | 26,660          | 112          | 1,171          | 1,802       | 582            | 774            | 286            | 1,222          | 2,270          | <b>41,096</b>   |
| <b>NET OUTLAYS</b>   |                |                |                |                 |              |                |             |                |                |                |                |                |                 |
| Net Outlays  |                |                |                |                 |              |                |             |                |                |                |                |                |                 |
| Gross outlays  | 9,441          | 8,535          | 1,731          | 49,372          | 335          | 4,372          | 53          | 1,084          | 1,107          | 1,374          | 1,044          | 5,866          | <b>84,314</b>   |
| Offsetting collections   | (1,295)        | (637)          | (20)           | (3,389)         | (87)         | (1,256)        | -           | (426)          | (9)            | (17)           | 8              | (1,951)        | <b>(9,079)</b>  |
| Distributed offsetting receipts  | (2,349)        | (33)           | (2,041)        | (7)             | (6)          | (111)          | -           | -              | -              | (1)            | -              | (273)          | <b>(4,821)</b>  |
| <b>Net Outlays</b>   | <b>\$5,797</b> | <b>\$7,865</b> | <b>\$(330)</b> | <b>\$45,976</b> | <b>\$242</b> | <b>\$3,005</b> | <b>\$53</b> | <b>\$658</b>   | <b>\$1,098</b> | <b>\$1,356</b> | <b>\$1,052</b> | <b>\$3,642</b> | <b>\$70,414</b> |

#### **4. Statement of Custodial Activity**

Substantially all duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP transfers the remaining revenue (generally less than two percent of revenues collected) directly to other Federal agencies, the Governments of Puerto Rico and the U.S. Virgin Islands, or retains funds as authorized by law or regulations. Refunds of revenues collected from import/export activities are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that CBP, as an agency of the Federal Government, has been authorized by law to enforce.

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal Government are paid and all regulations are followed. If CBP believes duties, taxes, fees, fines, or penalties are due in addition to estimated amounts previously paid by the importer/violator, the importer/violator is notified of the additional amount due. CBP regulations allow the importer/violator to file a protest on the additional amount due for review by the Port Director. A protest allows the importer/violator the opportunity to submit additional documentation supporting their claim of a lower amount due or to cancel the additional amount due in its entirety. Work in progress will continue until all protest options have expired or an agreement is reached. During this protest period, CBP does not have a legal right to the importer/violator's assets, and consequently CBP recognizes accounts receivable only when the protest period has expired or an agreement is reached. For FY 2007 and FY 2006, CBP had legal right to collect \$1.9 billion and \$1.8 billion of receivables, respectively. There was an additional \$2.7 billion and \$2.4 billion representing records still in the protest phase for FY 2007 and FY 2006, respectively. CBP recognized as write-offs \$183 million and \$204 million respectively, of assessments that the Department has statutory authority to collect at September 30, 2007 and 2006, but has no future collection potential. Most of this amount represents fines, penalties, and interest.

USCG collects various fines, penalties, and miscellaneous user fees from the public that are deposited to the General Fund miscellaneous receipts of the U.S. Treasury. USCG does not collect taxes or duties. As of September 30, 2007 and 2006, USCG had outstanding general fund receipt receivables due to the Treasury General Fund of \$7 million and \$10 million, respectively.

USCIS collects user fees from employers for nonimmigrant petitions under two Congressionally mandated programs. All user fees are collected when the petition is submitted. USCIS retains a portion of the fees to fund specific program expenses and transfers the remaining balance to other Federal agencies.

## **5. Risk Assumed Information**

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. That analysis shows unearned premium reserve is less than the estimated present value of unpaid expected losses by \$500 to \$600 million. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate.

Actual flood losses are highly variable from year to year. For the majority of years, this unearned premium reserve is adequate to pay the losses and expenses associated with this unearned premium. In those years with catastrophic flooding, the reserve will be inadequate, and the average across all years will be inadequate because of the subsidies in premium levels.

## Required Supplementary Stewardship Information (Unaudited, see Auditors' Report)

### 1. Stewardship Investments

Due to the transformational nature of DHS programs, stewardship investment information is presented only for FY 2007. Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefit. The Department's FY 2007 expenditures (including carryover funds expended in FY 2007) in Human Capital and Research and Development are shown below:

| Summary of Stewardship Investments (in millions) |                |                          |
|--|----------------|--------------------------|
| Programs   | Human Capital  | Research and Development |
| S&T – Research and Development Programs          | \$ -           | \$316.7                  |
| FEMA   | 101.4          | -                        |
| <b>Total</b>                                     | <b>\$101.4</b> | <b>\$316.7</b>           |

### 2. Investments in Human Capital

These investments include expenses incurred for programs for education and training of the public that are intended to increase or maintain national productive capacity and that produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity. Based on a review of the Department's programs, FEMA has made significant investments in Human Capital.

| Program               | Performance Measure   | FY 2007 Target | FY 2007 Results |
|-----------------------|---|----------------|-----------------|
| Grants Program        | Percent of jurisdictions demonstrating acceptable performance on applicable critical tasks in exercises using Grants and Training approved scenarios.                                   | 40%            | 72%             |
| Grants Program        | Percent of State and local homeland security agency grant recipients reporting measurable progress towards identified goals and objectives to prevent and respond to terrorist attacks. | 65%            | 67%             |
| National Preparedness | Percent of respondents reporting they are better prepared to deal with disasters and emergencies as a result of training  | 91%            | 89%             |
| National Preparedness | Percent of Radiological Emergency Preparedness Program communities with a nuclear power plant that are fully capable of responding to an accident originating at the site.              | 100%           | 100%            |

| Program                                       | Performance Measure  | FY 2007 Target | FY 2007 Results |
|---|--|----------------|-----------------|
| National Preparedness                         | Percent increase in knowledge, skills, and abilities (KSAs) of State and local homeland security preparedness professionals receiving training.                              | 27%            | 25%             |
| Urban Areas Security Initiative Grants - FEMA | Percent of participating urban area grant recipients reporting measurable progress made towards identified goals and objectives to prevent and respond to terrorist attacks. | 65%            | 63% estimated   |

### 3. Investments in Research and Development

These investments represent expenses incurred to support the search for new or refined knowledge and ideas for the application or use of such knowledge for the development of new or improved products and processes with the expectation of maintaining or increasing national productive capacity or yielding other future benefits. The following table shows key FY 2007 targets and results for research and development.

| Program                               | Performance Measure   | FY 2007 Target | FY 2007 Results |
|---------------------------------------|---|----------------|-----------------|
| Border and Maritime Security          | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 100%           | 80%             |
| Border and Maritime Security          | Percentage of transition program funding dedicated to developing technologies in direct response to DHS Components' requirements.                 | 94%            | 98%             |
| Chemical and Biological               | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 88%            | 89%             |
| Chemical and Biological               | Percent completion of an effective restoration technology to restore key infrastructure to normal operation after a chemical attack.              | 35%            | 30%             |
| Command, Control and Interoperability | Percent of States that have initiated or completed a statewide interoperability plan, such as the Statewide Communications Interoperability Plan. | 36%            | 89%             |
| Command, Control and Interoperability | Cumulative number of cyber security data sets contained in protected repository.  | 85             | 263             |
| Command, Control and Interoperability | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 75%            | 75%             |
| Explosives                            | Number of new or improved technologies available for transition to the customers at a Technology Readiness Level (TRL) six or above.              | 2              | 0               |
| Explosives                            | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 80%            | 61%             |



| Program                              | Performance Measure   | FY 2007 Target | FY 2007 Results            |
|--------------------------------------|---|----------------|----------------------------|
| Human Factors                        | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 90%            | 73%                        |
| Infrastructure and Geophysical       | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 90%            | 69%                        |
| Infrastructure and Geophysical       | Number of scenarios completed on the Critical Infrastructure Protection-Decision Support System that provide actionable information to help protect U.S. critical infrastructure. | 8              | 4                          |
| Innovation                           | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 45%            | 83%                        |
| Laboratory Facilities                | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 100%           | 93%                        |
| Testing and Evaluation and Standards | Number of Department of Homeland Security official technical standards introduced.  | 20             | 19                         |
| Testing and Evaluation and Standards | Percent of standards introduced that are adopted by Department of Homeland Security and partner agencies.   | 85%            | 84%                        |
| Testing and Evaluation and Standards | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 70%            | 88%                        |
| Transition                           | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 80%            | 100%                       |
| SAFETY Act                           | Percentage of full SAFETY Act applications that have been processed and feedback provided to applicant when package has been disapproved.   | 100%           | 100%                       |
| University Programs                  | Percent of peer review adjectival ratings on University Programs' management and research and education programs that are "very good" or "excellent."                             | 60%            | N/A – No reviews conducted |
| University Programs                  | Percentage of milestones that are met, as established in the fiscal year's budget execution plan.   | 80%            | 60%                        |

